2

Y4.Ec7: T19/31

S. Hrg. 99-656

THE IMPACT OF THE PRESIDENT'S TAX PROPOSAL ON THE MINING, TIMBER, AND AGRICULTURE INDUSTRY

ORIGINAL

COMPLETED

of 199

414

HEARINGS

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

FIRST SESSION

AUGUST 9, 12, AND 13, 1985

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
58-912 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

JOINT ECONOMIC COMMITTEE

[Created pursuant to sec. 5(a) of Public Law 304, 79th Congress]

HOUSE OF REPRESENTATIVES

DAVID R. OBEY, Wisconsin, *Chairman*
LEE H. HAMILTON, Indiana
PARREN J. MITCHELL, Maryland
AUGUSTUS F. HAWKINS, California
JAMES H. SCHEUER, New York
FORTNEY H. (PETE) STARK, California
CHALMERS P. WYLIE, Ohio
DANIEL E. LUNGREN, California
OLYMPIA J. SNOWE, Maine
BOBBI FIEDLER, California

SENATE

JAMES ABDNOR, South Dakota, *Vice Chairman*
WILLIAM V. ROTH, Jr., Delaware
STEVEN D. SYMMS, Idaho
MACK MATTINGLY, Georgia
ALFONSE M. D'AMATO, New York
PETE WILSON, California
LLOYD BENTSEN, Texas
WILLIAM PROXMIRE, Wisconsin
EDWARD M. KENNEDY, Massachusetts
PAUL S. SARBANES, Maryland

Scott Lilly, *Executive Director*
Robert J. Tosterud, *Deputy Director*

Subcommittee on Monetary and Fiscal Policy

SENATE

STEVEN D. SYMMS, Idaho, *Chairman*
ALFONSE M. D'AMATO, New York
EDWARD M. KENNEDY, Massachusetts
PAUL S. SARBANES, Maryland

HOUSE

CHALMERS P. WYLIE, Ohio, *Vice Chairman*
BOBBI FIEDLER, California
LEE H. HAMILTON, Indiana
DAVID R. OBEY, Wisconsin

CONTENTS

WITNESSES AND STATEMENTS

FRIDAY, AUGUST 9, 1985

Page
Symms, Hon. Steven D., chairman of the Subcommittee on Monetary and Fiscal Policy: Opening statement 1
Valiquette, John J., Hecla Mining Co 13
Schoonmaker, Wayne, accounting manager, Northwestern Mining Department, ASARCO, Inc 17
Mote, Karl W., executive director, Northwest Mining Association 18
Boeh, Robert E., president, Idaho Forest Industry Council 24
Hamilton, Willard I., Idaho State chairman, Forest Industries Committee on Timber Valuation and Taxation 25
Kyle, Al, president, Idaho Forest Owners Association 28
White, H.W. "Skip," executive secretary, Associated Logging Contractors of Idaho, Inc 30
Middlewood, Howard B., Jr., business consultant, Driftwood Consulting Services 40
Trail, David M., chartered financial consultant 43
Burton, John, farmowner 49
Walker, Fred 51
Hunter, Reverend, pastor, Coeur d'Alene Church of the Nazarene 56
Nettleton, Ed, forester, Sandpoint, ID 57
Kern, Jim, fireman 59

MONDAY, AUGUST 12, 1985

Symms, Hon. Steven D., chairman of the Subcommittee on Monetary and Fiscal Policy: Opening statement 67
Craig, Hon. Larry E.: Opening statement 79
Schmick, Ken R., assistant vice president, Sunshine Mining Co 80
Shonk, Lowell, administrative manager, Cyprus Minerals Co.'s Thompson Creek Mining Co 82
Gerick, Edward "Buzz," general manager, DeLamar Mine, NERCO Minerals Co 84
Jones, Milton; director, Federal and regulatory affairs, NERCO, Inc 86
Browning, John, president, Idaho Association of Realtors 97
Nelson, Rich, national committeeman and legislative chairman, National Association of Life Underwriters, and lobbyist, Blue Cross of Idaho 102
Cooke, Richard E., president, Boise Valley Chapter, American Society of Chartered Life Underwriters 117
Musko, David J., CPA 133
Cameron, Alan D., attorney, on behalf of the Idaho Credit Union League 148
Hurbi, Martin, CPA 167
Stivers, Hon. Tom, speaker, Idaho House of Representatives 168
Armstrong, Mark, dairy farmer 184
Hoveden, Tom, on behalf of the Idaho Cattle Association 190
Anderson, Andy, on behalf of the Idaho Petroleum Association 191
Shaw, Stephen K., chairman, Department of Political Science, Northwest Nazarene College 198
Van Hemert, Rick, executive director, Idaho Association of School Administrators 201
Howard, Mildred, president, Idaho Council of Senior Citizens 206
Williams, Duane, farmer 209

Page
Gilbertson, Stan, retired businessman 212
Hague, Dave 229
Smeed, Ralph 230
McMannis, Don, on behalf of the Food Marketing Institute 234
Brennan, Tim, president, Idaho Retailers Association 236
Winchester, Gene 245
Blasingame, Tom 246
Eastlake, Susan 247
Phillips, Wendell 249
Crim, John, vice president-treasurer, Moore Financial Group, on behalf of the Idaho Bankers Association 250
Gestrabek, Rudy 255
Carlson, Hon. Herb, Idaho State senator 257
Connors, John 258

TUESDAY, AUGUST 13, 1985

Symms, Hon. Steven D., chairman of the Subcommittee on Monetary and Fiscal Policy: Opening statement 261
Spencer, David, farmer 274
Moir, Gordon, farmer 278
Mitchell, Bruce, farmer 280
Loertscher, Thomas F., farmer 283
Jones, Mark, dairy farmer 288
Brewster, Del, executive director, Idaho Falls Chamber of Commerce 298
Kelly, Paul H., president, Northeastern Idaho Association of Life Underwriters 299
Mitchell, Gerald B 302
Stephens, W.J 304
Malone, DeeAnn, accountant, Data-Tax, Inc 307
Davis, Harold W., president, Electrical Wholesale Supply Co., Inc 310
Lathrop, Jennie Ruth, retiree 311
Whittaker, H. Dwight, executive director, Development Workshop, Inc 313
Fend, Edwin 326
Packer, Grant 327
Robbins, Gary 328
Andersen, Lloyd O 330
Wood, JoAn 333

SUBMISSIONS FOR THE RECORD

FRIDAY, AUGUST 9, 1985

Associated California Loggers: Letter offering information that will lead to the adoption of a proposal that not only simplifies the tax system, but is fair 62
McKinney, David L., financial vice president, University of Idaho: Written statement 37
Middlewood, Howard B., Jr.: Prepared statement 41
Symms, Hon. Steven D.: Charts reflecting U.S. Government spending, uncontrollable spending, outlays and receipts, long-term slide in business profitability, tax reform proposals, maximum corporate and small business tax rates, and tax change percentage by family economic income under the President's proposal 5
Trail, David M.: Exhibit reflecting the percentage of term insurance policies that mature into actual death claims 47
Valiquette, John J.: Letter, together with a memorandum, summarizing a study of the impact of President Reagan's tax proposals on Hecla Mining Co 14

MONDAY, AUGUST 12, 1985

Anderson, Andy: Prepared statement 194
Brennan, Tim: Prepared statement 239
Cameron, Alan D.: Prepared statement 152
Cooke, Richard E.: Prepared statement 121

Page
Crim, John: Letter to Senator Symms from V. Dale Blickenstaff, immediate past president, Idaho Bankers Association, dated August 12, 1985, relative to the President's tax reform proposal 251
Gilbertson, Stan: Prepared statement, together with attachments 215
Jones, Milton: Paper entitled "NERCO Position on the President's Tax Reform Proposal" 89
Musko, David J.: Articles, together with summaries, relative to tax reform and its effect on the State of Idaho 136
Nelson, Rich: Prepared statement 105
Stivers, Hon. Tom: .....
  Letter from Bill Ceverha, Texas House of Representatives, dated July 18, 1985, regarding the tax reform proposal 172
  Prepared statement, together a note subsequently supplied for the record. 176
Symms, Hon. Steven D.: Charts reflecting U.S. Government spending, uncontrollable spending, outlays and receipts, long-term slide in business profitability, tax reform proposals, maximum corporate and small business tax rates, and tax change percentage by family economic income under the President's proposal 72

TUESDAY, AUGUST 13, 1985

Kelly, Paul H.: Letter voicing opposition to the portion of the President's tax reform bill that would impose current taxation on life insurance inside buildup 301
Mitchell, Bruce. An equation reflecting a single flat tax that is fair to all income levels 282
Spencer, David: Prepared statement 277
Stephens, W.J.: Table reflecting the total impact of Reagan proposal on after-tax homeownership costs and home value by State 306
Symms, Hon. Steven D.: Charts reflecting U.S. Government spending, uncontrollable spending, outlays and receipts, long-term slide in business profitability, tax reform proposals, maximum corporate and small business tax rates, and tax change percentage by family economic income under the President's proposal 267
Whittaker, H. Dwight: Prepared statement 316

APPENDIX

Letters from various organizations and individuals regarding the tax reform proposal 335

THE IMPACT OF THE PRESIDENT'S TAX PROPOSAL ON THE MINING, TIMBER, AND AGRICULTURE INDUSTRY

FRIDAY, AUGUST 9, 1985

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in the Student Union Auditorium, North Idaho College, Coeur d'Alene, ID, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Joe Cobb and Dwight Ripley, professional staff members.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. Good morning. I appreciate the interest shown in the hearing this morning and the witnesses that are here.

I would say first that the primary reason for having these hearings, and we are doing this under the auspices of the Joint Economic Committee this morning, but the hearing record will be made available for the Senate Finance Committee, which will actually be the taxwriting committee that actually writes the legislation, which I am also a member. Although it's billed as a Joint Economic Committee hearing, it's also certainly serving a dual purpose for the Finance Committee. The purpose for the hearing is to allow people in Idaho to address the question of tax reform which the President has brought forth before the American people of how the proposal will affect Idaho.

Most of you that have had any experience watching Washington know a proposal starts out, and by the time a tax bill is written, and after it's gone through the House and the Senate and a conference, that oftentimes it is much different in the final form than it is at the outset.

There is a framework in the bill that the President has written, and there is a general philosophy behind the bill, but there will be ample opportunity in the future for many changes. My personal opinion is that the tax reform legislation, although it's scheduled to pass the Congress by December of this year, will not near see the light of day by December of this year. I think there are issues in that tax reform proposal that probably haven't even come to the minds of a lot of people just what would appear to be a small issue.

For example, employee ownership stock option plans, Senator Long and I were discussing that. He worked for 20 years to get those in the tax rolls. And he said he spent at least 6 weeks on that single issue in the Finance Committee, is the way he put it to me.

Many other issues are like that; mineral depreciation allowances and timber capital gains treatment, many others, second-home mortgage deduction, taxation of life insurance and other issues we are going to discuss, deductions for State and local taxes. Some of these things are definitely going to be issues that will take a long time to work a solution out.

The framework of the bill in Washington, the way they are working on it, is based on the philosophy of revenue neutrality. Revenue neutrality, the President, when he said the tax bill will be revenue neutral, his motivation was, he did not want to have a tax bill that would raise taxes; in other words, that when it's all over, it wouldn't raise any more revenue from the private sector to the Government than the current Tax Code.

Now, that's a good goal to have, but there is one problem with it. When they worship at the shrine of revenue neutrality in the taxwriting committee which, now that has been the game plan, Congressman Rostenkowski said it will be revenue neutral, that means when a Senator or Congressman offers that protection in the tax references in the Code, like say mineral depletion allowances, they say, "How are you going to pay for it? Where do you want to raise taxes to make up the difference?"

The reason they get in that problem is down in the bowels of the Treasury Department, the bureaucrats that work there, they use last year's numbers, too, and they use statistical calculations, and the Joint Tax Committee uses statistical calculations to submit what the proper predictions will be for revenue gain for the Treasury. When you use that kind of policy of revenue coming into the Treasury based on last year's economic activities and change the tax codes, they discount what people's motivations will be under a new taxing system. And so I think their numbers are in error, and I think that it makes it very difficult to get tax reform which, to have more fairness and equity in the Tax Code is the goal most Americans agree with. They would like to have a Tax Code they felt was more fair. Most Americans, when you inquire and talk with them about it, and most people in Idaho are telling me this, that most people think their own taxes are too high, and somebody isn't paying enough. And I think we all think that way. And that's only human nature.

So, I just want to say that what I want to find out today is for you to give me the input of how the proposed tax bill will affect Idaho, employment, and will it be more fair, will it make the Tax Code more fair, or is the Tax Code better the way it is today.

The President says out current Income Tax Code is a disgrace. Will the proposal he has here make it less of a disgrace? I think that is the kind of question you can address. If you don't address it in your comments, I will give you an opportunity in the question period to do that.

I want to introduce Dwight Ripley, who is chief counsel on my own staff. Rip is a lifelong, 30-year Idaho CPA. He is just new on my staff. He is retiring from his practice in Nampa to join my staff in Washington. He has been back there for a couple of weeks so he can see how things work in "Disneyland East," and he will be coming back to Washington in September. He will be here today, and he will maybe have a couple questions. But he understands Idaho well. He will be very helpful.

Joe Cobb is an economist with the Joint Economic Committee who's had a lot of experience with the House Banking Committee and Senate Banking Committee, and he is here to set up this hearing.

At this point, Joe, I would ask if you would take that pointer and go out there and just for the benefit of everybody here, just go through the charts. And we just have those here just to give you a little picture of what some of this is about before I go any further with my opening remarks here.

Mr. Cobb. Just briefly, these charts tell a story about where our economy is and how it has been over the last 7 or 8, 10 years.

The chart here on the right, spending has risen very dramatically from about $400 billion up to now $900 billion. And there are many reasons why spending has gone up. Part of it is inflation. But I want you to notice that there is a much more rapid increase of the uncontrollable entitlement programs. One of the reasons is that people take their wheelbarrow up to the Treasury and fill up with money and take it out because they are entitled to it. We support those because they help people that need help. But the fact they are "uncontrollable" is what is driving this budget deficit up.

This chart compares what Carter's budget would have been with what Reagan's has been. He cut spending, but it is going up too fast. As a matter of fact, people say in many ways maybe it was the tax cut of 1981 that caused the deficit.

And this chart here shows that's not true. The blue line on the bottom is revenue. Right here at the high point, that is the last year of the Carter administration when taxes were taking 23 percent of America's gross national product. Reagan's tax cut brought it down to the same level it has been for the last 20 years. But look what spending is doing; going up. Meanwhile, our economy has sort of got this mixed recovery. Some sectors are coming out very strong, and other sectors are still in the Great Depression.

Here is the chart showing the business profitability. That is the high point in 1963. Ever since then, business profitability has been going down with occasional bumps up. Here is the lowest level it has ever been now.

Tax reform proposals. Here is the tax reform proposal, three versions, compared to the present version in Washington today. This is the current system in which you have 14 progressive income tax brackets with the personal exemption of $1,040. Here are three other proposals most commonly debated. None of these will look like the final version. The final version will be a mixture of all these plus new ideas. Here is the Reagan plan that came out the first of this year increasing the personal exemption to $2,000 and having three brackets, 15, 25, and 35 percent.

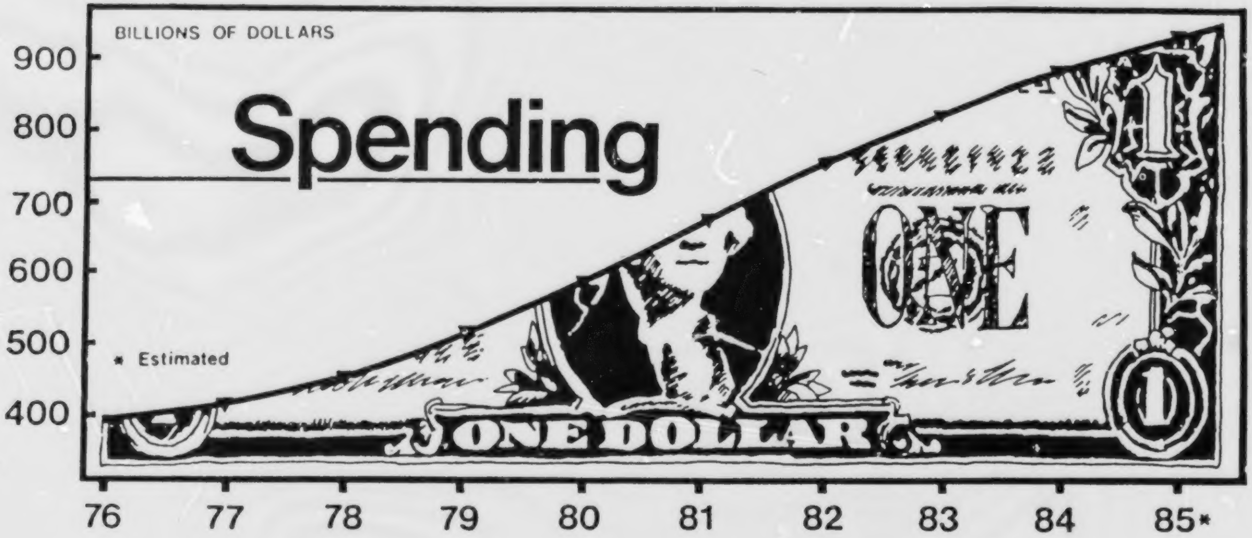
This is the version that the Republicans came up with, also has a $2,000 personal exemption but only two brackets, 19 and 29 percent and has a much simpler system of business tax reform.

This is the Democrats' favorite version that only has $1,600 for personal exemption and three brackets, 14, 26, and 30 percent.

For businesses, the three versions also have different schedules with the Reagan plan having the lowest tax rate but the most complicated system of business depreciation adjustments and other things like phasing out depreciation allowance. And here is the maximum rate of the three plans.

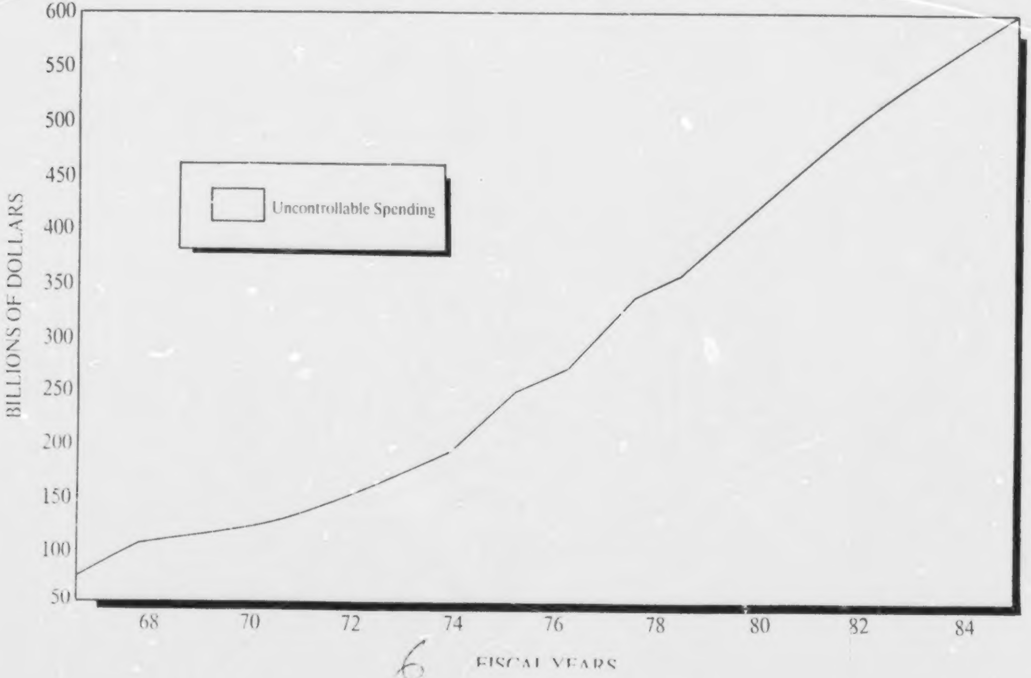
This chart here is the most complicated. It shows what happened to people in different income categories. Some of them get tax increases, most of them get tax cuts, and most people don't change at all.

[The charts referred to follow:]


BILLIONS OF DOLLARS
900
800
700
600
500
400
Spending
* Estimated
ONE
ONE DOLLAR
1
76
77
78
79
80
81
82
83
84
85*

"Uncontrollable" Spending from 1967 to 1985

(Entitlement Programs, Price Supports, Interest on Debt)



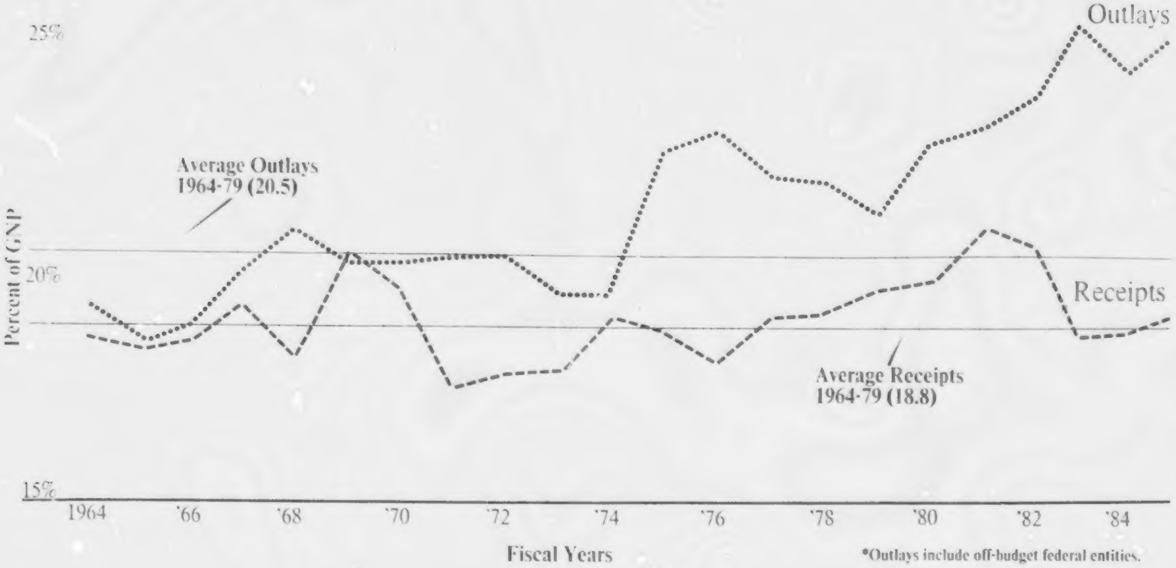
6

BLANK PAGE

BLANK PAGE

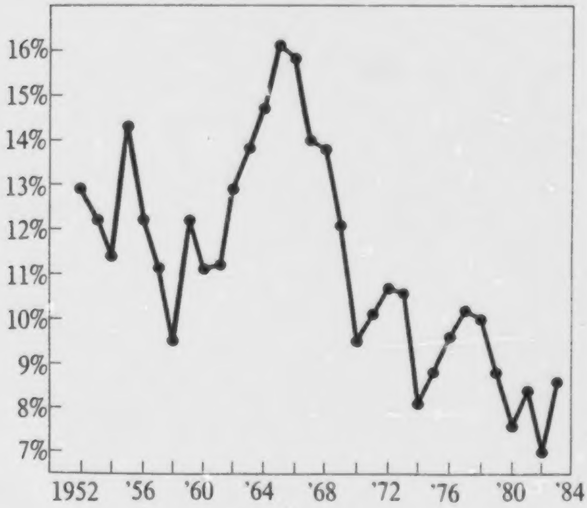
BLANK PAGE

Outlays and Receipts
Percentage of GNP, 1964-1990



*Outlays include off-budget federal entities.

Long-Term Slide In Business Profitability*

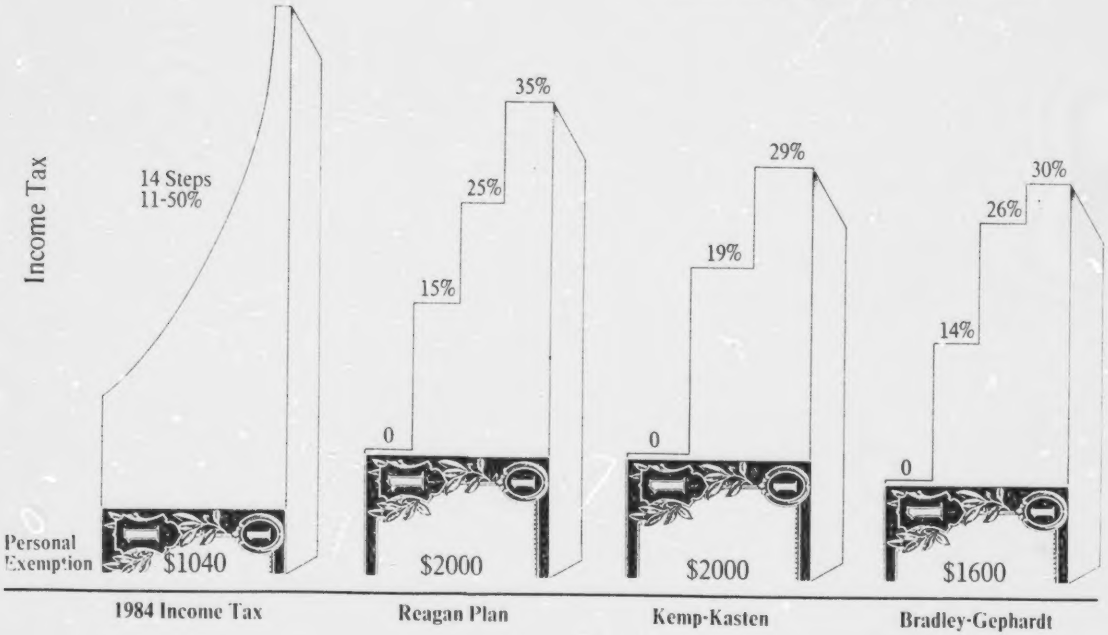


*Nonfinancial corporations. Pretax profits (with inventory valuation and capital consumption adjustments) plus net interest as a share of the net stock of reproducible fixed capital at replacement cost.

Chart /Senate Republican Conference

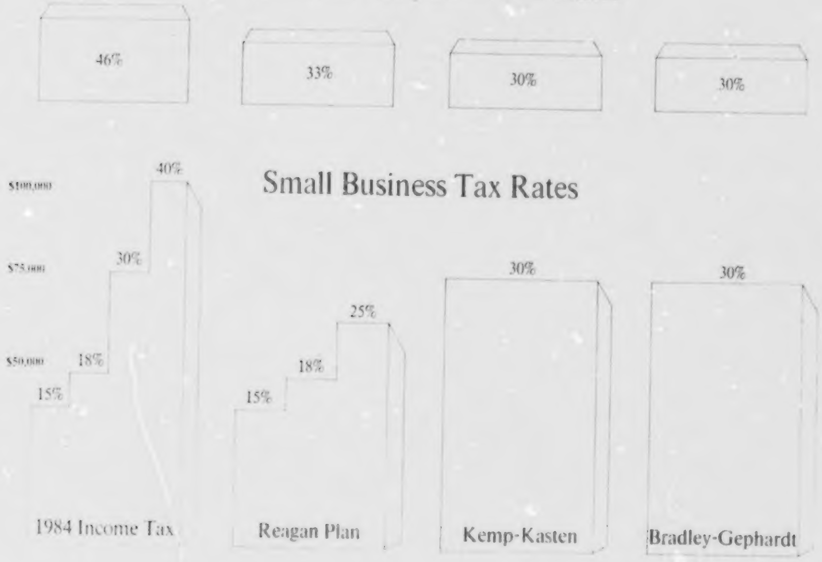
Tax Reform Proposals

Married Couple With Two Children



9

Chart /Senate Republican Conference



Maximum Corporate Tax Rates

Small Business Tax Rates

10

Tax Change Percentage
by Family Economic Income (Under the President's proposal)

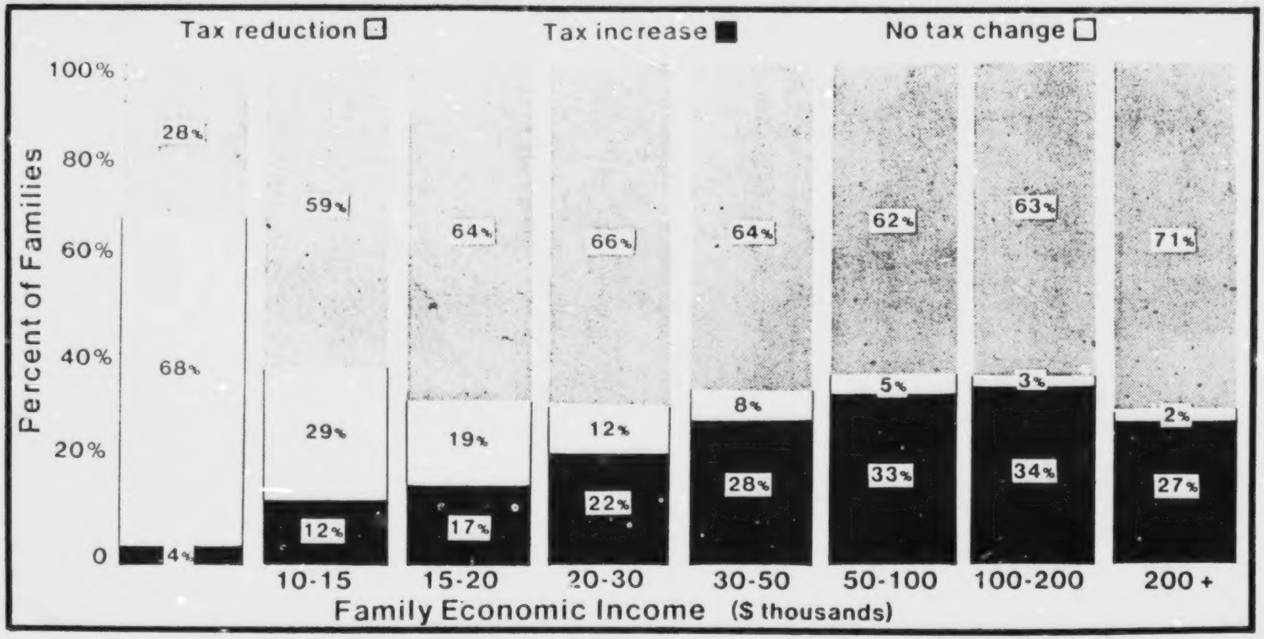


Chart /Senate Republican Conference

Senator **SYMMS**. Thank you, Joe. I wanted to have those charts here for people to look at during the day, and it might create some things they would want to say or think about how it would affect them because, as I say, we get plenty of input in Washington from some of the groups that represent some of you here in Idaho, maybe some that don't, but from the interest groups located there that lobby the Congress. But we want to hear directly from here about how you think tax reform affects you and how important the issue is to you.

Social Security taxes have gone up. That is another item that has become a big cost of taxation for both businesses and individuals, the amount of money that's committed to the Social Security program. That has to be considered also.

And I think that the other question we have to think about is, our State is a resource producing State. The big employment in Idaho is in agriculture, in timber, and in mining. That's the major source of earning a living of the people in this State. These people that do this, whether you are in the service-related industry supporting mining or an actual miner or working in the mining company itself, it is an internationally traded commodity, and I think we want to look at the tax proposal, revised version of our income tax to make us more or less competitive. The timber industry we want to make more or less competitive. We want to make the grain producers more or less competitive. If we are not going to be competitive internationally, it's up to me as a member of the Finance Committee to make changes in the bill which will in fact make the Tax Code in a situation where we would be more competitive, because we have to be competitive if we are going to be able to keep our jobs based here in Idaho, have our young people to be able to work and live in the State in which, in my opinion, is the most single important thing is to be able to have a tax system or an economic system so the young people in Idaho can look forward to a future living in this great State. And I think that's why this issue is so important.

There is not a single person in Idaho that will not be affected in Idaho by tax reform. Tax reform is very popular for politicians to talk about, but it is not always the same, what the speeches are and what the actual proposals sometimes come out, they are a little bit cloudy.

I might also mention here in the room today is Jack Girard from Senator McClure's staff, who has been tracking this bill very closely in the Senate Finance Committee for the chairman.

I think Ruthie Johnson is here from my staff.

The first witness will be John—I have a hard time pronouncing your name.

Mr. **VALIQUETTE**. Valiquette.

Senator **SYMMS**. John Valiquette, Hecla Mining Co., Wayne Schoonmaker of ASARCO, and Karl Mote of Northwest Mining Association. Why don't all three of you take a seat up there? Your entire statements will be made a part of our record.

And what I would like to say also, I mentioned that Dwight Ripley is new on my staff. He's had a great deal of experience in taxes, doing accounting for businesses in Idaho, but I might just say that most of Rip's practice has been businesses in southwestern Idaho in the Twin Falls area, which is primarily agricultural.

If your tax people have any technical points on timber or mineral depreciation as a result of this hearing, please have them contact my office, and we have a CPA there that understands how it will affect you. But we would like to have you know we want to get direct input of how these issues are going to affect Idaho.

Let's start right off on the way the program calls for, and the first witness will be John Valiquette. If you can keep your remarks between 5 and 7 minutes, it would be helpful for the program. We have 16 witnesses on the program. There may be a couple others here that wish to say something before the day's over. Go right ahead.

STATEMENT OF JOHN J. VALIQUETTE, HECLA MINING CO.

Mr. **Valiquette**. To date the information Hecla Mining Co. has presented to this committee has focused on the effect of President Reagan's tax proposal on the company's overall Federal tax burden. The question that has not been addressed in this testimony is what we perceive as the long-term effects of the President's tax increase on Hecla's ability to operate mines in the United States.

We cannot say what the 56-percent increase in Federal taxes will force Hecla Mining Co. to close operations or to shut down mines next week or next month. We can say, however, that the increased tax burden that will result from the President's tax proposal will hamper Hecla's ability to sustain current operations over the long term and to invest in exploration for and development of new mines.

This erosion in competitive position will come about due to a general reduction in capital available to Hecla for investment in the minerals industry. Capital that is vital to sustain current operations and to remain competitive in the world markets.

The reason Hecla would experience an overall reduction in investment capital is twofold. First, as the Federal Government raises taxes, Hecla would have fewer dollars remaining after taxes from current operations. Second, because of the lower earnings after higher taxes, banks and other investors would be less likely to invest money in the minerals industry.

Putting it altogether, the President's tax proposal is not good news for the mining industry. From our point of view it is not a plan for "fairness, growth, and simplicity," it is a plan that means an erosion of our ability to compete in the world market and to sustain a minerals industry in the United States. Thank you.

[The letter and memorandum attached to Mr. Valiquette's statement follow:]

COPY For ____________________

June 10, 1985

The Honorable Steven D. Symms
Senator, State of Idaho
509 Senate Hart Office Building
Washington, D.C. 20510

Dear Steve:

In accordance with your recent request, I am forwarding herewith an internal memorandum summarizing a study of the impact of President Reagan's newest tax proposals on Hecla Mining Company.

The study uses our actual earnings performance over the past five years as a basis for a comparison between our tax liability under existing legislation and that under the President's proposal. In our highly cyclical business, we think it important that any such study cover a period of approximately the price cycle in silver in order to be meaningful. We have chosen here to use the five years 1979 through 1983, and we consider the average for this period to be the most important number. We have also assumed that the proposed depletion allowance phase-out would have been completed by the start of this period. We have further assumed that the operating loss carryforwards which affected our actual tax in recent years did not exist, since they are an abnormal situation.

The bottom line is that the latest tax proposal would increase our federal income tax liability by 56%. This is primarily the result of the loss of the depletion allowance. It is an improvement over the proposals first proposed by the Treasury Department, primarily because the latest proposals do not change our ability to expense exploration costs as they are incurred. However, a 56% increase in our federal income tax is going to have a serious impact on our ability to compete in the world mining scene. As you are well aware, this is the arena in which we must compete because silver is a commodity traded world-wide with a price set on a world-wide free market. Although other aspects of the President's tax proposals do impact us, we feel we could live with them if we could retain the present depletion allowance.

Please be assured that we are very much in favor of the idea of tax simplification. We fail to understand, however, why a so-called "tax neutral" tax simplification bill need involve, first, a tax shift from individuals to corporations; and second, a conscious further shift of tax burden from service and other kinds of businesses to those of us in the struggling natural resource industries.

If you or members of your staff are interested in further details of this study, please feel free to contact Mr. W. J. Grismer, Senior Vice President of Hecla Mining Company, who would be pleased to answer your questions. You are free to use this information in any way that you see fit.

Sincerely yours,

Wm. A. Griffith
Chairman

WAC:jg
Enc: 1
cc: WJG

HECLA MINING COMPANY

June 7, 1985

MEMORANDUM TO: W. A. Griffith

FROM: William J. Grismer

SUBJECT: The President's Tax Proposals

As a comparison, the attached schedule sets out the effect of the new tax proposals compared with actual results on a scale-out for five years - 1979 through 1983 - ignoring NOL benefits and using averaging to get a five-year total. While the computation is rough, it does reflect the effect of the proposals.

The point is, the present law approach gives a five-year total of $12,208,000 (line A) versus the new proposal of $19,102,000 (line B), or an increase of approximately 56%.

The major causes are:

(1) Percentage depletion would be lost (i.e., phased out over five years.)

(2) The comparison reflects the capitalization of 20% of exploration and development expense, which is already required for years after 1984 (as part of the 1984 tax reforms).

(3) The change in depreciation allowances from the ACRS (Accelerated Cost Recovery System) system put into effect in 1981 and the proposed CCRS (Capital Cost Recovery System) system would have only minimal effect on Hecla.

(4) There is an "alternative minimum tax" proposed, but the loss of percentage depletion (comparatively) more or less renders this tax moot in our example, except for the five-year transition period (1986-1990) where we phase out percentage depletion by 20% each year. (The effect of this phasing out is not reflected in our example.)

We can discuss this matter at any time.

William J. Grismer

WJG:skp
Enclosure
cc: ABrown
TTGiles
RHWallace

BLANK PAGE

BLANK PAGE

BLANK PAGE

HECLA MINING COMPANY
COMPARISON OF PROPOSED TREASURY TAX SCHEME WITH ACTUAL FOR PAST 5 YEARS (EXCLUDING NOL RELATED ITEMS)

6-7-85

($000)

			1983		1982		1981		1980		1979	
	Per law in effect during those years - Excluding NOLs											
	Taxable income (loss) per return filed		$ -0-		$(9,193)		$(12,736)		$ -0-		$ (4,230)	
	Add back - NOLs		11,774		-0-		-0-		34,482		-0-	
	Restated taxable income (loss)		11,774		(9,193)		(12,736)		34,482		(4,230)	
		5 year totals										
	Regular tax @ 46%	$ 9,244	5,416	Pref Item	(4,229)	Pref Item	(5,859)	Pref Item	15,862	Pref Item	(1,946)	Pref Item
	Minimum tax - Hypothetical	4,143	783	$(10,639)	963	$(2,190)	74	$(328)	- -	$(12,707)	2,323	$(10,999)
"A"	Investment credit	(1,179)	(735)		(192)		(30)		(216)		(6)	
	Tax payable	$ 12,208	5,464		(3,458)		(5,815)		15,646		371	
	Adjustment - Estimated to reflect the President's Tax Proposals											
	Taxable income (loss) as above - Ignoring NOLs		11,774		(9,193)		(12,736)		34,482		(4,230)	
	Add:											
	Percentage depletion in excess of cost depletion		10,635		1,620		326		12,717		11,009	
	ACRs depreciation		1,785		435		80		- -		- -	
	* Exploration and development expense - Capitalize 20% (Note: 1983 is only increased from 15%)		362		1,927		2,569		810		317	
	Deduct:											
	Estimated CCRS depreciation in place of ACRs		(2,012)		(497)		(88)		- -		- -	
	Dividend paid deduction - 10% of dividends		(281)		- -		(447)		(87)		- -	
	CCRS depreciation on capitalized exploration and development expense		(1,199)		(1,216)		(706)		(221)		(52)	
	Revised taxable income (A)		21,064		(6,924)		(11,002)		47,701		7,044	
	Tax @ 33%		6,951		(2,285)		(3,630)		15,741		2,325	
	or											
	Alternative minimum tax											
	Revised taxable income (A)		21,064		(6,924)		(11,002)		47,701		7,044	
	Add preference items											
	Percentage depletion (already eliminated)		- -		- -		- -		- -		- -	
	Capital gains - Preference portion - Not significant		- -		- -		- -		- -		- -	
	Excess of exploration and development cost expensed - Over 10 year amort.		2,960		5,462		8,801		2,759		1,142	
	Basis for alternative minimum tax		24,024		(1,462)		(2,201)		50,460		8,186	
	Tax @ 20%		4,805		N/A		N/A		10,092		1,637	
		5 year totals										
"B"	Larger - Tax due	$ 19,102	6,951		(2,285)		(3,630)		15,741		2,325	

*Note - This charge is already law as part of the 1984 Tax Reform Act.

16

Senator SYMMS. Thank you very much, John. Next, Wayne Schoonmaker.

STATEMENT OF WAYNE SCHOONMAKER, ACCOUNTING MANAGER, NORTHWESTERN MINING DEPARTMENT, ASARCO, INC.

Mr. SCHOONMAKER. My name is Wayne Schoonmaker. I am accounting manager for the Northwestern Mining Department of ASARCO Inc., located in Wallace, ID. My primary area of responsibility is with accounting matters for the mining operations in the Northwestern United States. This statement is submitted on behalf of ASARCO, Inc.

ASARCO is a major U.S. miner, smelter, and refiner of silver, copper, lead, and zinc and their byproducts. The company operates mining and/or processing facilities in Idaho, Montana, Arizona, Missouri, Tennessee, Ohio, and Illinois. In Idaho, ASARCO operates and holds a 50-percent interest in the Coeur mine and a 37.5-percent interest in the Galena mine, which in 1984 produced 2.5 and 4.2 million ounces of silver, respectively.

In order to determine the effects of the President's tax reform proposal on the development of a new mine, ASARCO recently conducted an analysis to determine what the effects would have been on the ability to develop the company's Troy, MO, silver-copper mine, which began production in 1981. This analysis revealed only a marginal negative impact on net cash-flow return on investment, if the Troy property has been planned and developed using the administration's proposed tax regime—principally because the lower corporate tax rate proposed by the administration program would offset the adverse effects resulting from elimination of the investment tax credit and the percentage depletion allowance, as well as proposed tightening of depreciation allowances.

However, it is important to recognize some key factors affecting this type of analysis. First, it must be emphasized that every mining property is indeed unique, and the tax impacts can differ according to a variety of considerations, such as ore grade, production, type of mineral produced, and other variables affecting profitability.

Second, since the marginally negative effect in our Troy analysis is based upon a reduced corporate tax rate proposed by the administration, we have some concern about the future of a lower rate and whether it wouldn't be negotiated at least partially away during the give and take of the tax debate and whether the rate would not be increased in future years in order to deal with persistent budget deficits.

Despite the results of our analysis comparing the effects of the present system with the President's proposal, ASARCO is still concerned that the elimination of percentage depletion and the investment tax credit will remove specific direct incentives to help develop new mining properties. The generalized long-term effect of eliminating these incentives will be to provide investors the opportunity of better and more immediate returns from other types of investment and will likely be to divert capital to shorter term investments with less risk. The consequence of this and proposed changes in treatment of exploration and development expenses will be to discourage new mineral development in the United States, thus increasing our Nation's import dependence for industrial raw materials over the long term. The effect will also be to discriminate against Western States, like Idaho, that are dependent upon natural resources investment for their long-term economic future.

As an example of the kind of impact that just the two properties in which ASARCO has an interest can have upon the Idaho economy, let me provide you with some basic data on the contribution of the Coeur and Galena units combined with the ASARCO Wallace office. Together these operations employed an average of 450 workers in 1984, with a total payroll in Idaho of $14.5 million. Fringe benefits add an additional $3.4 million. In addition, these facilities paid combined total taxes of $2.25 million to the State in 1984, and withheld an additional $842,000 from employees' paychecks for Idaho State income tax in 1984. In addition, these units made $3 million in purchases in the State of Idaho, mostly in northern Idaho, last year, not including utilities or fuel.

Finally, ASARCO has some very real concerns about the overall effects of the tax reform proposal upon our Nation's international competitiveness, particularly in capital-intensive sections. Our interest here extends not only to basic industries such as mining and mineral processing which, as you know, must operate in highly competitive environments for markets and capital, but also to our customers. The markets for nonferrous metal products depend heavily upon a healthy capital goods sector and on investment in new and replacement equipment. We are concerned that the administration proposal, by removing incentives for capital investment such as the investment tax credit and accelerated depreciation, will unfairly skew investment in favor of service or high technology sectors at the expense of basic industry and capital spending.

Thank you for the opportunity to provide ASARCO's views on tax reform.

Senator SYMMS. Thank you very much, Wayne. Karl Mote, please proceed.

STATEMENT OF KARL W. MOTE, EXECUTIVE DIRECTOR, NORTHWEST MINING ASSOCIATION

Mr. MOTE. Thank you, Mr. Chairman, please accept these comments for the record concerning the proposed major revision of the Federal tax structure. The comments are made on behalf of the trustees and members of the Northwest Mining Association, whose 2,200 members depend on reasonable economic and governmental climates to survive. Unfortunately, neither is present today, as we have only a 50-percent employment rate today and a poor outlook for the future.

Many in the business of production of minerals will submit data on specific effects of the new tax proposals. Also, we are aware that a comprehensive study of financial effects of the proposals is being done by the Arthur D. Little Co. on behalf of the American Mining Congress, and will be presented to you next month. Therefore, I will not attempt to evaluate specific dollar effects of the proposed changes, but rather, wish to explain the overall effect of lower profitability on today's producers and tomorrow's developments.

The mining industry is a high-risk, capital-intensive business. The time required to discover and develop a new deposit averages more than 10 years, and the cost is usually measurable in tens of hundreds of millions of dollars. It is critical that the producers make a reasonable profit if they are to attract the capital to develop new reserves. The present tax system recognizes these facts with depletion allowance and investment tax credit. Those provisions should be preserved.

Our industry is in its worst depression since World War II. We cannot compete with foreign sources in the production of many metals. The plight of the copper industry is well known, and most of our base metals and ferrous metals are in the same straits. Our higher costs of production and lower grade deposits have us sitting on the sidelines while the Third World countries produce the bulk of the world needs without our restriction of having to make a profit. And when our foreign competitors have difficulties, our Government grants them financial assistance and assures their continued production.

The case has been made repeatedly for maintaining a domestic production capability for critical and strategic minerals. Mineral policies clearly state the intent to be self-reliant for these materials. Further, it is a fact of economics that new wealth, and the growth it provides, come only from natural resource production.

We cannot produce the minerals if we cannot make a profit and the skilled workers lost to other industries during low production periods such as the present will make it slow and costly to return to critical production levels.

We must maintain a strong domestic industry, and that means we must maintain the financial structure and the supportive Government that encourages discovery, development, and production of minerals. Critical to this is a supportive tax structure that rewards production, one which invites investment in the industry, and one which recognizes the high capital costs, long leadtimes and high risk. Whitney and Whitney, consultants in Reno, showed in a recent study of taxes on mineral production, that the total tax load varies from one-third to nearly one-half of the value of mined product. To increase taxes would hardly be considered supportive.

We believe the new tax structure should retain depletion allowance, should continue a fair capital cost recovery, and maintain the deduction of exploration and development costs.

Senator SYMMS. Thank you very much. I want to thank all three of you for very thoughtful and I think excellent statements that certainly should be considered by the members of the taxwriting committee that I know have an interest in seeing this country maintain a resource base.

I want to ask all three of you a couple of questions. But I might just first frame the first question for you.

In our current Tax Code we have a bias in the Tax Code that has developed over many years against savings. And basically that bias comes from the fact that if you borrow money, you get to deduct the interest; and if you save money and invest it in the bank, the Government taxes you on the savings. If you invest in equity capital in stocks and in corporations, those dividends are taxed not once but twice. So, there is a different bias in our taxing system against savings.

From that has been two reasons why we have things like mineralization depreciation allowances and accelerated depreciation investment tax credit, historical tax credit, municipal bond deductions, is to mitigate people's capital cost so they can recover their capital. I think you all understand that.

But would you be happier if the President is going to give speeches about fairness and equity in the Tax Code simplification, if he would start from the moral high ground of removing the bias against savings as the first step and then set this thing up as a 5-year goal instead of a 6- or 7-month goal and let the American people discuss the issue in a rational light for much of 7 months so they could figure out what it is they want to do with the Tax Code? Would you be happier if we start there from the moral high ground and started to change a few things? Do you understand what my question is? In other words, if you had a flat tax and had no deductions, then you could give the same speech if you are Ronald Reagan, as he does. Really, you would be talking about tax reform.

Now, if we are talking about tax change, change taxes on resource producers and lower them on individuals, do you think we would be starting on a moral high ground if we started in that position? Do you see what I am saying? Give you 100 percent spending for any business investment you make on any capital investment for unlimited loss carryforward, you close the source and do away with all deductions so you remove the bias from the Code. That's not being talked about in Washington.

If corporations paid taxes on the income, if they paid dividends, you don't charge taxes on the dividends. You only tax income once.

Mr. **Valiquette**. I would be in favor if they took away the bias against savings and capital investment.

Senator **Symms**. From what the three of you said, this proposal does not take away the bias against savings.

Mr. **Valiquette**. I don't believe so; no.

Mr. **Schoonmaker**. No; I don't. And I think one of the arguments that can be made for some of the tax incentives that apply to the mining industry is the high risk involved in mining ventures. And incentive for savings I think would encourage, maybe, money for capital investment.

Senator **Symms**. If we did away with the double taxation of dividends, that would help equity financing through high risk of exploration for drilling—I mean for looking for minerals?

Mr. **Schoonmaker**. Certainly.

Senator **Symms**. Then equity financing, sell stock, and people put money in, and you could go out and look for the minerals. Down the road, people might hope to get a return back without having a tax on their capital. But that isn't the proposal. I think they are talking about maybe 10 percent of that or something.

But the next question I do want to ask, and it's a question I'm going to, it's a lot easier than this first question I asked.

What do you think is more important for the mining industry? And when I say the mining industry, I am talking about for the men that work up at Hecla and ASARCO just as much as I am for those of you who are in the management of the companies. What is more important for me to be doing as a U.S. Senator, for the Senate as a group, restricting the growth of Federal spending or working on tax reform?

Mr. MOTE. Cut the Federal spending. That's the only way we can survive. I think that has to be a major first step, is cutting spending. I don't think you can talk about lowering taxes, even being taxed neutral, if you have Federal outlays in excess of revenues you are taking in. I would agree——

Senator SYMMS. All three of you, then, agree what Congress needs to do is reduce spending; and if we've got spending in line with current revenues, then we could talk about tax reform on much more of a rational basis than can be done today?

Mr. VALIQUETTE. I would think so.

Mr. SCHOONMAKER. Yes.

Mr. MOTE. Yes.

Senator SYMMS. I am happy you gave that answer, since I agree with it.

Mr. VALIQUETTE. Where do you see the possibility for cutting any Government spending? That's the big question, that nobody wants to give up their entitlement programs.

Senator SYMMS. It all needs to be put on the table. And you do the same thing in Government that you do in private business. The first place you have to cut costs is personnel costs, and that's true in any business. And, therefore, those Americans out there that are not getting paid more money today than they were 4 or 5 years ago, and in some cases taking pay cuts or reductions, numerical reductions, that has not happened with respect to the Federal Government. And I would think a pay freeze for the Federal Government would be a good place to start. And I've advocated that for several years. And starting with the President's salary and the Congress and everybody else, it would be a good start. And then we have to have an adjustment, I think, and a realistic appraisal of what we can afford to pay in all the pension systems and an adjustment on the cost-of-living adjustments. That would save billions of dollars to start off with. And then I think there can be billions saved because there is 1 million people, for example, working in the civilian part of the Defense Department. If you cut that number to 900,000, it would not jeopardize the security of anyone in this room. And you can't convince me about that. But there are not enough in Congress that share that view. But I think that they will soon be here.

The other question I wanted to ask, you all really have already said it, but what you really said was that this bill will not make you more competitive with offshore mineral production. Bill said it makes you less competitive.

Mr. VALIQUETTE. I agree. We sell on the world market. And the prices are determined by those markets. And if taxes increase, it makes us less competitive. We can't pass the costs on.

Senator SYMMS. Joe, do you have anything to ask?

Mr. COBB. One comment on this one idea. People like Senator Metzenbaum say it is impossible to have a minimum tax, that basically he says that any preferences that any company has received since 1981, that was in excess of the straight-line depreciation, you know, that would have to be recovered regardless of making a profit in prior years, you would still have to pay money to the Government. Would you comment? I know the Tax Act of 1982 was a big serious hit on the profitability of the mining industry, and I would like you to comment on this other proposal now being put forward by the Democrats to basically increase the taxes on business retroactively. What would that do to your own operations in Idaho?

Mr. SCHOONMAKER. Well, I think anything retroactive would be disastrous. We are having trouble making money under current conditions without going back retroactive to any provisions. I think corporations in general, and I know the mining companies pay a minimum tax on certain tax incentives they receive now. As I said before, I am not a tax expert, but I know there are certain amounts of minimum taxes that are paid by corporations.

Mr. COBB. Mr. Mote.

Mr. MOTE. I can't see that an increase in taxes regardless of the reason can be helpful in any sense. I think retroactivity in taxation is terrible. I think it is. It's the wrong——

Senator SYMMS. Immoral?

Mr. MOTE. That's a darn good word.

The business of having to compete with offshore where there is no competition in the same sense that we have, there is no need for a profit, there is no definition of "profit" in the sense that we have to operate. And then, of course, the fact that you are feeding so many of those foreigners to make sure they stay in competition. All of those things are contributions to a terrible position. I am not a tax expert. I am a dumb engineer having worked on the operating site most of my life. But it doesn't take a heck of a lot to see if we have a 5-percent margin and take 7 percent away from it, we shut down. It's just that simple.

And, Senator, you have a flaw in your logic as you pointed out a minute ago, and that's the fact—it's very difficult to find logic in the various tax proposals.

Senator SYMMS. One question that needs to be asked, not related to this, Bill, but directly would affect the mining industry and certainly the smelting and processing industry. And I think ASARCO still has a little bit of that left.

Superfund legislation is before the Congress. The Superfund legislation, the current Superfund law has what is called a feedstock tax. It taxes mostly petroleum refining and chemical production. Primarily, about 12 companies pay most of it. It's about $3 million a year. The administration has proposed to increase that tax to about $5 billion over a 5-year period, or to triple it up to about $1 billion a year and keep it based on the feedstock tax.

The Senate Finance Committee passed a bill which broadens the base a lot and includes a lot more people, and they call it a wage-end tax where they charge so many for the product that would come under the Superfund.

Would you want to comment on that? Do you prefer changing that mode of taxation on the Superfund, or would you rather leave it alone the way it is now, take the administration's proposal or the method of taxation the Senate Finance Committee——

Mr. SCHOONMAKER. I am not too familiar with what's involved, you know, in the bill.

Senator SYMMS. What I would like to do is—we'll keep the record open, and you ask that maybe of your people in New York, and we will let whatever they want to say come in.

Mr. SCHOONMAKER. I am sure I could get a written response to that.

Senator SYMMS. I would like to have a written response to that area for our record. I would like to get that in this hearing record, because that is an issue that is related—it's a tax, and it's related to this bill. It's a tax on industry, and they are talking, as you know, the Kellogg area has been delegated as a Superfund site. I want to get up to Kellogg again. I was there last night. I will be up Saturday. But I would like to look at it before this summer is over, maybe get someone from EPA to show me, or some of you people to show up there and see exactly what it is those people propose to spend $50 million on to clean up, because I fear if you are starting to stir up that pile of slag up there, you will have it all stirred up, and maybe it is more stable the way it is now. I am not an engineer, but I would like to have some questions answered on that.

The Superfund question I think is one that foreign competitors don't have to deal with that; and there again, we have another arrangement that will make it less competitive. But I thank you very much.

If we have any more questions, we will submit them in writing for our record. But I appreciate your testimony greatly.

Mr. SCHOONMAKER. Could I just make sure I understand what you are after on the Superfund financing question?

Senator SYMMS. I would like to know why ASARCO prefers the tax method that the Senate Finance Committee voted for and what the reasons are, why they support that and why they would oppose the current system in a very concise answer. I am already confident that their position is that they favor what the Senate Finance Committee did. I have been getting a lot of criticism we are starting a new form of taxation. It's a broader base tax. It allows for more people to pay, so it isn't all one or two industries. It's spread out over a broader base. Many people are saying it's the beginning of a value-added tax, and it may end up being that's what will finance all the socialism.

In your role, is the added-value tax something we should not get started in this country? I appreciate having that as part of the record, though. Thank you all very much. I appreciate your testimony.

Now we will talk about the timber industry. We have Bob Boeh of Plum Creek Timber Co. representing the Idaho Forest Industry. Bob, are you here? We have Will Hamilton of Potlatch Corp. We have Al Kyle of Idaho Forest Owners Association. And we have Skip White of Associated Logging Contractors.

Gentlemen, we welcome you here this morning.

One thing that I think the four witnesses probably all agree with, there ought to be a tax on Canadian timber. About 30 percent; right?

Mr. WHITE. That's for sure.

Senator SYMMS. Thirty, forty, fifty.

Mr. WHITE. That's on the right track.
Senator SYMMS. Mr. Boeh.

STATEMENT OF ROBERT E. BOEH, PRESIDENT, IDAHO FOREST INDUSTRY COUNCIL

Mr. BOEH. Mr. Chairman, I am Robert E. Boeh, president of the Idaho Forest Industry Council and manager, Coeur d'Alene Unit, Plum Creek Timber Co. My statement today is made on behalf of both IFIC and my employer, Plum Creek Timber Co. IFIC represents 40 individual timbergrowers and wood products manufacturers in Idaho, and Plum Creek Timber manages 170,000 acres of forest land in Idaho. Plum Creek Timber Co. manages for timber production and compatible multiple uses.

Few will quarrel with the stated goals of the President's tax reform proposal. We agree that striving for "simplicity" and "equity" in the tax code is a laudable objective. However, both these criteria are missing as the proposed reforms apply to timber taxation. Moreover, these reforms, if enacted, would only add to the economic woes of what is currently a very troubled, but nevertheless major, portion of Idaho's economy—the timber industry.

Under the current law, most timber income earned by either corporations or individuals is taxed at lower long-term capital gain rates. This is neither a "loophole," nor an accident. Rather, it is a purposeful, thoughtful decision to recognize in the Tax Code the long-term, high-risk nature of timber investments, and, by taxing income from these investments at a lower rate, to stimulate more of them. The basic premises behind this decision which dates back over 40 years as basic U.S. tax policy are still valid—timber is still a long-term, high-risk investment, and considerable quantities of it are still needed to meet future domestic and international demand.

Under the administration's proposal, however, the sound basis for maintaining capital gains treatment is ignored. For corporation, taxes on timber income would increase 17.8 percent under the President's proposals. In addition to outright tax increases on timber income, there are "hidden" tax increases inherent in the administration's proposal. Historically, those who invest in timber growth have enjoyed the same tax benefit as all other taxpayers who have incurred expenditures to manage, conserve, and/or maintain property held for the production of income—that benefit being the current deduction of such expenditures for Federal income tax purposes. Similarly, current deduction has also been generally allowed for property taxes and interest. The current deductibility of such costs has been vital to the cash-flow requirements of the tree farmer—and pivotal in his decisions concerning the extent to which forest land can be economically reforested and intensively managed. Again, the result of changing this provision of the law will only be to make Idaho's timber industry less competitive.

As a forester for Plum Creek Timber Co., I am responsible for the management of the company's timber lands in Idaho. I must economically justify to the company's management all the expenditures I recommend. Of course, certain minimum reforestation practices are mandated by State law. Beyond that minimum however there is much that could be done to enhance the growth of established tree crops. If we lose the current deductibility of such expenditures for Federal income tax purposes, I will be hard pressed to justify the level of intensive crop management we have been practicing in the past.

It is particularly disheartening to see the administration come forth with tax recommendation which are neither fair nor simple for this industry. We are struggling for survival and trying our utmost to maintain our ability to compete with Canada's industry. These tax proposals fly in the face of logic, sound economic policy, and the important role that our industry plays in Idaho's economy. Neither Plum Creek Timber Co. nor IFIC can support the reform proposals, and we join our industry colleagues in other States in the following recommendations:

One. We recommend the existing treatment for timber capital gains provided by section 631 (a) and (b) be continued, and, to the extent that section 1231 applies to depletable property, it too should be continued.

Two. We recommend that the present treatment of timber management expenses and carrying costs be continued. This would provide timber owners with the same treatment as the owners of other assets—a treatment that is less favorable that received by the owners of other natural resources under current law and under the proposal.

Three. We recommend the retention of the present incentives for reforestation, which benefit primarily the small landowner.

Four. We recommend that fairness should be achieved by reducing the alternative corporate capital gains rate to maximum noncorporate capital gains rate. This would enable timber owners to select the form of business for the conduct of their operations without regard to artificial constraints imposed by the tax system.

Thank you for the opportunity to present our views.

Senator **Symms**. Thank you very much for a very concise and direct statement.

Will Hamilton from Potlatch Corp.

STATEMENT OF WILLARD I. HAMILTON, IDAHO STATE CHAIRMAN, FOREST INDUSTRIES COMMITTEE ON TIMBER VALUATION AND TAXATION

Mr. **Hamilton**. Good morning Senator. My name is Will Hamilton and I'm here to share with you five different perspectives on the impacts of the tax reform proposals currently before Congress as they relate to the forest products industry generally and to the business of tree farming specifically. I am first a taxpayer. I am Idaho State chairman for the Forest Industries Committee on Timber Valuation and Taxation and serve as its spokesman on timber taxation. I am cofounder and a principal officer in the second largest private forest nursery in the State of Idaho. I am employed as a corporate timber tax specialist for Potlatch Corp. and I'm also a graduate forester.

As a taxpayer, I wholeheartedly support the goal of the administration's tax reform proposals. Their goal is to change our present tax system into a model of fairness, simplicity, efficiency, and compassion by removing obstacles to growth and unlocking the door of innovation and achievement. There are different means to this end, however. I have three specific comments to make as a taxpayer. The first is that my livelihood and ability to pay taxes in the first place comes from the forest. I see my future as a taxpayer in jeopardy. The second is that the reform proposals, although heralded as being revenue neutral, may in fact represent a net loss to the U.S. Treasury. My third and greatest concern is that national debate over tax reform will focus attention away from a critical issue: the Federal budget deficit. No amount of reassurance will persuade me that a healthy economy can coexist indefinitely with current deficit levels.

As a timber tax spokesman, I am deeply troubled by the administration's proposal to eliminate timber capital gains. In 1944 Congress enacted tax legislation designed to eliminate discrimination in the taxation of timber and to stimulate conservation and reproduction of timber as a critical natural resource. Prior to 1944 timber management on private forest lands was virtually nonexistent. Current law has now reversed that situation. The theory behind the proposal to eliminate timber capital gains is that equal incomes should bear equal tax burdens. This view ignores the economic and social considerations that are always present in framing the different parts of a tax structure. Capital gains treatment of timber income, as well as that of all capital gains, is based upon an economic justification. It should not be destroyed by conceptual and theoretical arguments, divorced from practical situations in the business world. There are understandable and practical distinctions between ordinary income and capital gains which should be recognized in any tax structure. Tax reform has often been looked upon as a means to move toward the social and economic goals of society. Tax reform can play a strong role in maintaining healthy and balanced economic growth. It can only do so, however, if it is done wisely. Timber capital gains works. It has caused a turnaround in the Nation's timber management and reforestation. A repeal of timber capital gains would create a serious imbalance in the economy. In the timber world, the effect upon investors, timber landowners, processors, and communities would be disastrous. Everyone who deals with wood products, from the forest to the ultimate consumer, has a vital interest in fostering the incentive to grow and manage timber which depends on timber capital gains.

My perspective as a businessman gives me concern over the administration's proposal to repeal the 10-percent investment credit and 84-month amortization rules currently available to qualified reforestation expenditures. These reforestation incentives provide small and medium-sized landowner the encouragement to replant their lands after harvest and to place idle timber land back into production. Almost 70 percent of the nonpublic commercial forest land in our Nation is owned by private nonindustrial landowners. They are truly the Nation's woodbasket. Without good forestry, the management of these private timber lands for timber production becomes a marginal economic enterprise at best. Eliminating these reforestation incentives will cause the private landowner to plant fewer trees at a time when he should be planting more. If fewer trees are planted, fewer trees are grown in private nurseries. This means fewer greenhouses are built, fewer people are employed and less taxes are paid. We will all suffer the long-term consequences of reduced timber production on the Nation's private nonindustrial timber lands at a time when projected timber supply may fall short of timber demand.

My fourth perspective is that of a forest industry employee. The administration's proposal requiring all timber management expenses to be capitalized is absurd. Currently, costs of timber stand establishment must be capitalized and may be recovered only when the mature timber is sold. Most other timber management costs, including carrying costs and the costs of silvicultural practices, may be currently deducted. The reasons given for the proposed change is to more properly match taxable receipts with deductions relating to multiperiod production activities. Timber production is specifically mentioned in the reform proposal because of the perceived number of tax shelters involving the so-called natural deferral industries. I have no knowledge of even a single timber tax shelter. The administration's proposal may, in fact, create de facto long-term timber tax shelters by combining cost capitalization with basis indexing which, under current market conditions, could yield taxable losses rather than tax gains. Timber is a unique capital asset requiring long holding periods before maturity. The proposal requiring timber management cost capitalization discourages forest management. It defeats the goal of tax simplicity by requiring multiperiod accounting rules that would confuse and befuddle even the most sophisticated timber owners. Taken together with the loss of timber capital gains, the wood products industry would be at a distinct disadvantage in competing with other industries for investment dollars. Senator Packwood summed it up best when he recently stated "This isn't tax reform, its the deliberate act of sabotaging an entire industry * * *." As a forest industry employee I couldn't agree with him more.

My fifth and final perspective on the tax reform proposals is that of a professional forester. Foresters are trained to think in the long term and realize their efforts will benefit future generations. I have here in my pocket a seedling that was grown this year under a climate of fair timber tax treatment. I would like to give it to you and hope that as you plant it, you keep in mind these facts. During the last 10 years almost 8 billion board-feet of timber was harvested from private forest lands in Idaho. Timber production from private lands directly supported over 15,000 jobs with an annual payroll in excess of $200 million. Sustaining this level of production well into the future will require the regeneration of at least 7 million trees annually. Many of these trees will not be planted if the tax reform proposals affecting timber capital gains, reforestation incentives, and capitalized forest management costs are enacted. Expected timber losses resulting from misguided tax reform are largely irreversible. An acre not planted results in timber volume foregone forever. It is with great seriousness, and all puns aside, that I submit to you that the future of sound forest management, a healthy Idaho forest products industry, and the Nation's future timber supply rest in the hands of Congress. I trust you will carry that tree and this message with you back to Washington, DC. Thank you, that concludes my statement.

Senator Symms, I have here in my pocket an Idaho white pine seedling I would like to give to you.

Senator SYMMS. Thank you.

Mr. HAMILTON. It was grown this year under a climate of fair timber tax treatment. As you plant that tree, I hope you will remember the following facts. During the last 10 years almost 8 billion board-feet of timber was harvested from private land in Idaho. This timber production supported over 15,000 jobs with an annual payroll of in excess of $2 million. In order to sustain this level of production, it will require the regeneration of over 7 million trees. And like if the tax reform proposal affecting timber goes against a program for reforestation incentives, many of those trees will not be planted.

Senator SYMMS. I thank you very much. And I guess what you are saying is that if somebody already has a tree farm planted, and it's growing, that there may not be much competition for them in the future as far as anybody else planting trees.

Mr. HAMILTON. That's correct.

Senator SYMMS. I brought up the same question to a fellow Senator about that treatment of orchards and vineyards the same way, and I am more familiar with them than I am with trees. And I told him if I was a less-principled person, I wouldn't even oppose that. But you cut out all of the competition for the entire established orchard business in the Northwest, there is no competition because nobody will be able to afford to go into the business.

As far as the environmental question is concerned, the Sierra Club and others ought to be out really screaming about this particular issue, because we will see a reduction, I am convinced, in tree planting. Most of us like to see trees grow.

Mr. HAMILTON. It is my hope that you will carry that tree and this message back to Washington, DC, because with all great seriousness and puns aside, I submit to you that the future of sound forest management, a healthy Idaho forest products industry, and the Nation's future rests in your hands and the hands of Congress.

Senator SYMMS. I thank you very much. Mr. Kyle, please proceed.

STATEMENT OF AL KYLE, PRESIDENT, IDAHO FOREST OWNERS ASSOCIATION

Mr. KYLE. Senator Symms and members of the committee, I am Al Kyle, president of the Idaho Forest Owners Association and am also the owner of forest land just north of Coeur d'Alene. I appreciate this opportunity to testify before this committee on behalf of the Idaho Forest Owners Association and for myself as a forest landowner as to the effects the President's tax reform proposal will have on the owning and managing of private, nonindustrial timber lands.

The Idaho Forest Owners Association is an organization whose primary objectives are to represent and educate our State's forest landowners. Representation, at both the State and national level, is necessary to provide a healthy, positive economic and regulatory environment in which to grow trees. The educational aspect of the association is vital to landowners who choose to optimize timber land productivity, while providing for wildlife habitat, maintaining water quality, and maximizing the recreational opportunities and aesthetic values we all enjoy. Productive, well-managed forest lands are crucial to Idaho's as well as the Nation's, economy.

Forest lands, left unmanaged, produce at 50 percent of their capacity. Research and practical experience by forester and woodland owners, however, have shown that active, intensive forest management can substantially increase productivity capabilities. This is not without costs; site preparation, planting, brush eradication, fertilization, insect and disease control and precommercial thinnings are forest management activities which may be required to maximize growth, but can prove to be a substantial investment. Many of these costs must then be capitalized, until which time the timber reaches maturity, often decades, and the subsequent harvest. This is not to mention the risk involved with growing trees; for which there is no reasonable insurance available. A fire or epidemic insect attack can destroy a lifetime's worth of dollars and sweat for a forest landowner. This makes timber a very unique, long-term investment requiring special tax treatment.

In 1944, Congress enacted legislation which reflected this need for special tax treatment. It was designed to eliminate unfair and inequitable discrimination in the taxation of timber and to stimulate conservation and reproduction of timber as a critical natural resource.

The reasons Congress passed this legislation are as applicable today as they were in 1944. The more than four decades of beneficial economic experiences of fair timber tax treatment attest to its importance and effectiveness in encouraging the conservation, management, and reproduction of timber.

IFOA recognizes the need for tax reform, both from the standpoint of simplification and the need to create equity amongst taxpayers. In all of the recent tax reform packages a problem arises however, when the subject of timber is addressed. The effects that President Reagan's tax reform package will have on the desirability of investing in forest land and on forest management are devastating. There are essentially three major areas of concern for forest landowners contained within the administration's proposal.

Long-term capital gains treatment for timber has been eliminated for those owners who maximize timber production through sound forest management. Under the proposal, woodland owners who manage their lands and operate their property as a business would not qualify for capital gains treatment, even if the revenues generated were from a once-in-a-lifetime harvest. On the other hand, a forest landowner who choses not to manage and could care less about forest management would qualify for capital gains treatment if he ever decided to harvest. The penalties this tax proposal will inflict on forest landowners who actively manage their woodlands could greatly endanger the availability of timber for future generations. There needs to be more incentives, not less, to optimize the productivity of our timbered acreages if we are to meet projected wood fiber demand.

Under the current law, the costs of acquiring and establishing a timber stand are capitalized. The costs of maintaining or managing it, as well as interest and property taxes, are expensed or deducted from ordinary income. Under the President's proposal, all timber management expenses would be capitalized, including overhead, property tax, and interest. Besides unfairly treating forest managers, simplification is not obtained as the proposed capitalization rules are extremely complex, inequitable, and inconsistent with accepted accounting standards.

IFOA's third bone of contention with the proposed tax reform is the elimination of the reforestation tax incentive. This incentive provides forest landowners the encouragement to replant their lands after harvest or to place idle timber land back into production.

Trees are our only renewable resource, but they must be managed throughout their life's cycle. Forest management is a long-term, high-risk investment that must be given special tax treatment if the integrity of our privately owned forest lands is to be maintained.

Thank you for giving me the opportunity to testify before you today.

Senator SYMMS. Thank you, Mr. Kyle. Skip, glad to have you here.

STATEMENT OF H.W. "SKIP" WHITE, EXECUTIVE SECRETARY, ASSOCIATED LOGGING CONTRACTORS OF IDAHO, INC.

Mr. WHITE. My name is H.W. "Skip" White, I am executive secretary of the Associated Logging Contractors of Idaho, Inc., which is an association of independent logging contractors who live and operate throughout the State of Idaho. Basicly we are family owned and operated types of small independent businessmen. We pride ourselves in being one of the last vestiges of the true free enterprise system. In 1982 when we provided testimony to the STAA hearings our numbers were over 900, our present membership in the ALC is less than 600. I would not try to tie the STAA of 1982 to our reduction in membership, but it has had a significant impact on the cost of doing business in the forest transportation part of our business. Let me provide you with an example of the costs of log trucks in the State of Idaho:

1982—3rd quarter Federal tax—$920.43.

1983—3rd quarter Federal tax—$2,747.89.

This tremendous increase in fuel tax occurred at the same time period as log prices and obviously truck prices were declining. In addition to that we had a significant change in the excise tax paid on log truck tires. One of the significant facts that you failed to consider in the passage of the STAA of 1982 was in some cases the extremely short life expectancy of tires operated on log trucks in the State of Idaho. It is not a bit unusual for tires to have a truck life of less than 500 miles and in some cases as short as 50 miles do to the rocks and other types of driving hazards we encounter. We sincerely appreciate your committee's consideration and the established 25-percent reduction in the cost of registration for log trucks, but I would like to emphasize that we haul during a quite limited season mainly during daylight hours, as well as hauling empty one way on every trip that we make to the log yard. I state this only because I still stand firmly convinced that rather than the 25-percent reduction we should in fact have a 50-percent reduction on registration. We feel that in the past we have justified this throughly and still ask for your further consideration for an additional 25-percent or a total of 50-percent reduction in registration on log trucks. For your information I would point out that in the State of Idaho we have approximately 640 miles of interstate routes of which 570 miles are south of the Salmon River and approximately 70 miles north. I would like to add to this that approximatley 65 percent of logging in the State is done north of the Salmon River and 35 percent is either done south or east of the Salmon River. The STAA of 1982 designated that 60 percent of the money collected would be mandated for the improvement of the Interstate Highway System therefore leaving approximately 40 percent for primary, secondary, and forest highway roads, as well as bridge, railroad crossings, and other types of structures that are required for a highway network. I am certian that this committee well remembers our comments concerning the increase that was forced on us by the STAA of 1982. We have in fact learned to live with this increase and once again I commend this committee in their agonizing consideration of what should be done in a most fair and equitable method and agreeing basically that the Interstate System was in dire need of repair. As I understand information provided by the Idaho State Department of Highways and other entities involved in road construction and road maintenance most all of the necessary projects and improvements to the Interstate System in Idaho have either been completed, construction is underway, or money and projects have been allocated.

The people that I work for and represent spend less than 10 percent of their hauling miles on the Interstate System. Gentlemen, our problem is not interstate, our problem is the so-called farm to market road network, which includes the primary, secondary, and county road system. We are willing to continue paying the fuel tax as described under the STAA of 1982 if you are willing to shift the emphasis from the Interstate System to the primary, secondary, and county road system of the State of Idaho. It simply does us no good to have the finest Interstate System in the universe if we cannot get the products that we haul from the forest work roads to that Interstate System. The secondary roads that are mainly used by log haulers in the State are in such condition that load limits go on way before there is any damage and are left on long after there is any need on the long chance that damage will occur, due primarily to the fact that these local units cannot accept any risk or damage because they are so short of money. Mr. Chairman and members, if we are to continue the STAA at its present levels of taxing we strongly urge that you consider heavily funding the so-called farm to market sector of the road network in the United States of America.

We also ask for your consideration in increasing the speed limit from the present 55 miles per hour, which if I understand correctly was imposed on the United States to affect reduction in fuel consumption. The 55-mile-per-hour speed limit simply does not fit in many parts of the State of Idaho and other States of the West.

We strongly feel that any money generated by Federal fuel tax paid by trucks should be spent only on highway improvement. We also suggest that alternate methods of highway construction financing should include the toll road concept. We see nothing wrong with those that use a facility, pay for that facility. There is a great need in the State of Idaho for rerouting and changing and improving many of our primary roads. I suggest to you that Highway 95 is an outstanding example of toll road financing could and should be used to provide an up-to-date modern highway network from the north of Idaho to the south. Thank you for your consideration and I would certainly attempt to answer any questions that you or members of your committee would ask of me.

Senator SYMMS. Thank you very much.

I want to start right off by asking the same question I asked the miners.

Bob, going back with you, What is the most important, in your perspective in the forest products industry, to have the Federal Government get spending back in line with current revenues or to tamper with the Tax Code? That's a loaded question. But tax reform, even for all the high noble goals the President may set forth for reducing and controlling the Federal budget——

Mr. BOEH. We long supported getting a handle on the Federal deficit and continue to think that should take precedence.

Senator SYMMS. When you say "get a handle on the Federal deficit," there is two ways to get a handle. One is by reducing spending, and one is to raise taxes.

Mr. BOEH. Reduce the spending.

Senator SYMMS. I think there is an important difference, and oftentimes, you know, I hear the political leaders in the country, they continue to talk about the deficit. We have to reduce the deficit. I keep trying to remind myself to say, I want to reduce spending, because reducing the deficit, if we reduce the deficit but still spend 25 percent of the GNP, I think still we are going to find we have a problem, because it means we are—I guess private people would have to borrow money the Government now borrows to pay the deficit off, because I don't know where the people are going to get the money. I haven't found too many people operating that have an excess of cash in the bank account. Everywhere I go, I can't find anybody that has any money. They manage to pay the bills, those that are lucky, but they don't have surplus cash in the account. Private individuals and businesses I am speaking of. So, if they raise their taxes, they have to go to the bank and take a loan out to pay it, if they have the equity.

And then that's why I differentiate. You say reduce the expenditures.

Will, do you——

Mr. HAMILTON. Yes; I agree. The priority should be the deficit or tax reform and to reduce spending.

Mr. KYLE. One of the things we have to consider also is the ability of the taxpayer to pay the tax. If the burden on the taxpayer is so much that he simply cannot operate his business, or whatever, he is not going to be paying taxes in, which the Government is using to pay off their debts. So, I think it still comes back to simply having to reduce what's being spent.

Senator SYMMS. Skip.

Mr. WHITE. Senator, I already think the priority—or problem—one of the problems in our business certainly is not taxes at the present time. We are trying to keep our companies or businesses operating. I believe that the deficit certainly, is a very strong part of that process. I would hope we could reduce the deficit and hopefully reducing Government spending as well. But it's imperative that that deficit start downhill. It simply cannot go any higher and not have an impact on our business that we are going to live with for 25 or 30 years.

Senator SYMMS. Well, I concur with that.

And I am going to take the liberty, since we've got the forest people here, just to ask a brief question about this, the question of the Canadian timber, because I personally believe that the time for talking with the Canadians is long since passed. And the longer you talk to them, the more they are going to keep talking to us and keep on shoving timber in the United States. Probably if we were operating in Canada, we would be doing the same thing. And this is the point, we have to just take care of our own people. And your figure of 450 is very alarming to me because you are talking about logging contractors who have—What is the average employment of those contractors when you say you lost 400 members in 5 years? How many people do they employ?

Mr. WHITE. Senator, our work force is probably down by 33 percent in the last 4 years.

Senator SYMMS. In terms of jobs?

Mr. WHITE. Yes.

Senator SYMMS. Of course we had the trauma of the Clearwater County closure of Potlatch to live with in the last few weeks that certainly strikes close to home.

But with respect to Canadian timber, I am going to ask a hypothetical question. If in fact tomorrow morning the U.S. Government imposed a 30-percent tax, tariff, duty, whatever definition you want to put on it, on all Canadian softwood timber that came into the United States, would this have an immediate positive impact on the competitiveness of our industry?

Mr. WHITE. Me, sir?

Senator SYMMS. Yes; I want to ask all of you. There is an argument for quotas, or there is an argument for tariffs.

It was on the news this morning that the President now has on his desk a recommendation which the Federal Trade Commission—that they impose quotas on shoes for 5 years. The President has been studying it, and he may instead of imposing a quota impose a tariff on shoes for 5 years to give the shoe industry a chance to catch up with their foreign competition in this country.

I am asking the question, do you think a 30-percent tariff would be enough in terms of the subsidy involved in the Crown Timber, the way they sell their timber, do you think a 30-percent tariff would make us competitive again and give our industry breathing space?

Mr. WHITE. Senator, I think it makes us competitive, although I think that the only thing that must be considered is, if it's going to make the dollar stronger, then we are going to come back in 2 years, and if the dollar is 50 percent parity with the Canadian dollar, you are going to have to raise it another 50 percent. I would like to see it weakened and get back to the real world.

I have been involved in this process for 15 years, and we competed against the Canadian lumber products for years and years and years. We have no changes in the Canadian base. We have no changes in the American base other than, in my estimation, the difference in the value of the dollar. I believe the thing we are—really get hurt with is that strong dollar.

Senator SYMMS. Thirty percent would offset it, wouldn't it?

Mr. WHITE. Yes; it would, Senator. But I am also concerned it might further strengthen that dollar. And I am afraid we might just be chasing our tail on that.

Senator SYMMS. The economists I talked to want to find out how to kill the dollar. If you have a 30-percent tariff on everything, you get the dollar down, but I don't know whether it would work that way or not.

Mr. WHITE. If it's correct, I am certainly all for it.

Senator SYMMS. The big problem with the American dollar isn't that the dollar is so strong, as the foreign currency is so weak. They've had so much socialism in Europe, they all destroy the investment incentive, and they look to the United States for buying dollars. It's caused our dollar to come up. If Europe's economy would catch on fire, they would start investing over there. The Swedes are taking the Canadian market, and the Canadians are taking our market. And it is related. I agree the dollar has a big impact on it. But I don't know whether the tariff would be better than the quota or not. My concern about the quota—and I am not going to quibble over a quota, if that's what it's going to be. But I think it might difficult to keep it accounted for, because we have a wide-open border for 2,000 miles with Canada, and you can practically drive through anywhere back and forth. And I don't know how anybody is going to keep track of it all. It's going to lead to a black market. They've done that. It was pretty well proven when they had quotas on oil; all kinds of oil was changing definitions. It became old oil, new oil, and the oil industry came up in Houston to transfer oil from old categories to new categories. It became a cottage industry.

But, Al, what do you say about that?

Mr. KYLE. I think I would intend to agree with Skip. I am not that much of an expert on the Canadian costs. I understand it's an entirely different system which put us in a different ballpark, but perhaps a tariff or quota would be fair. But my overriding concern is still the same as Skip, there is a problem with the dollar. And I really don't know what would happen in the long run, that it would be good or bad. Maybe it would retaliate to other industries. It's a real can of worms that would be hard to——

Senator SYMMS. If we had flexibility in our system and had control of our forests out here instead of the Federal Government, we would start giving timber away to the sawmill companies, and they could compete with them. They could literally go out and open up a forest and start sawing trees. But that's what we ought to be doing. We've got timber all over the place. You can get in an airplane and fly over here about 10 miles to the east and turn south, and you can fly for 100 miles over nothing but trees. But they are all tied up in one kind of a management plan or another. You can't get at them. If we could open them up and saw, we would compete with anybody. But we are not doing that. What I would like to do is take them on and compete with them and cut down all the other old trees that need to be cut down and grow new ones and grow them a lot faster, and you could sell more timber then.

Mr. KYLE. There is an advantage from the other standpoint of tourism. The big factor tends to be, however, there is so much free tourism, we don't have a good handle on what its value really is and what the effect would be from that type of thing. I don't know myself. I've never seen any figures about that, but that's another consideration also.

Senator SYMMS. Will.

Mr. HAMILTON. In direct answer to your question, a reduction in Canadian lumber would be of benefit to the U.S. forest products industry. I am a tax person and not an economist, and I don't know what the proper methodology would best be appropriate. My concern, the root of the problem is the Federal deficit, reduce the Federal deficit.

Mr. BOEH. I think I would agree with what has already been said about the strength of the dollar and creating some of the problems.

We do have a concern about the tariff situation and what the Canadians might do in response to that, I guess. But definitely some kind of a—whether a tariff or some kind of control on the amount of Canadian imports coming into this country would be definitely of a benefit.

Senator SYMMS. OK.

Any questions, Rip?

Mr. RIPLEY. I don't think so.

Mr. COBB. I wanted to inquire about the differences—I am not from the West myself, so my question might be naive. But the Crown Timber in Canada has a very low stumpage fee, and I understand stumpage fees here in the United States are significantly higher than that because of the way in which the Department of the Interior conducts the auction. Would you comment upon that method and any suggestions you might have that we could look at for different ways of handling it here south of the border?

Mr. BOEH. I think that would be a whole new topic. Probably if you want to talk about it, maybe we could discuss it later.

Senator SYMMS. We probably should not get into that. We ought to let the State run the land, and that would help. But that is another controversial question. We won't start on that either.

But I thank you all very much, and you made a good presentation, and I appreciate having this for backup material for some of our arguments which I can present to Senator Baker and others.

We are talking about an industry that has lost 5,000 to 6,000 employees in the last couple of years. We are talking about just in Idaho, not counting Oregon and Washington. And anything that would increase the cost of doing business, like increasing taxes, is going to be detrimental to jobs in Idaho, is really what you are saying.

And, Skip, each one of these people who you have a logging contract with that drops out, if they are out of business, the ones you are talking about, they hire anywhere from 5, 10, to 50 people, I suppose. When you say 450 members you lost, I was trying to get—you say 33 percent employment. How many jobs are you talking about?

Mr. White. In one instance, Senator, we lost one company that employed probably as high as 250 people.

Senator Symms. We are talking about 250 families that are in problems.

Mr. White. That was one company.

Senator Symms. Just in one company. That's what I mean. So, it's a crisis situation. It's not a situation that can be put off or a situation for crisis for these families.

Certainly in Orofino where you have 8,000 people living in—4,000 people living in the town and lose 800 jobs, I would imagine that seeing 137 logging trucks going through town like the other night, it certainly can't be any more concerning that for those families thinking, what are we going to do the next month or the next year, whatever.

I appreciate your testimony.

Going on to a different point of view on some things, some different issues about how it relates to the tax bill. This is on the impact of various tax proposals on individuals and small businesses.

Dave McKinney of the University of Idaho. Dave is not here. I understand he is not coming. I would ask that the written statement of Dave McKinney from the University of Idaho be inserted in the record at this point.

[The written statement of Mr. McKinney follows:]

Testimony Offered by David L. Mc Kinney, Financial Vice President, University of Idaho, for the Joint Economic Committee on Tax Reform. Coeur d' Alene, Idaho. August 9, 1985.

The purpose of this testimony is to comment on potential impacts upon the University of Idaho of President Reagan's tax reform proposal and the November, 1984, treasury department tax reform proposal. I will consider impacts which directly affect the economy of Idaho, those which affect university operations or revenue sources, and impacts which affect our employees and thus affect the institution indirectly.

1. Effects on the Economy of Idaho. The University of Idaho will be affected by any federal tax change which results in increases in taxes to individuals or corporations that reduce disposable personal income and business profits in Idaho. Any such reductions will reduce consumer spending and business investments, and ultimately reduce the state tax revenue base. Specific issues of concern include:

> a. Uniform Production Cost Rules applied to natural resource industries such as mining, and to a certain extent lumbering, eliminate capitalized cost recovery for wasting assets, thereby significantly and immediately affecting profitability of basic Idaho industries not yet recovered from the effects of the 1980-83 recession.
>
> b. Cash Flow. Repealing the investment tax credit and accelerated cost-recovery system depreciation would increase the costs of capital investment and reduce cash flow. These effects could be partially offset by indexing of depreciation. Repeal of income averaging would increase the tax load of individuals with variable annual incomes--of particular concern to Idaho farmers. Presently Idaho agriculture is in poor financial health. So are Idaho's other natural resource industries--lumbering and mining. Implementing any changes in tax laws which accelerate existing stresses on these basic resource and capital intensive industries will have severe short and long run impacts on the economy of the state.
>
> c. Bad Debt Reserve Deduction. Eliminating this deduction would significantly affect profitability of the banking industry. Many Idaho banks are currently stressed by a high percentage of marginal agricultural loans and in the process of revaluing bad debt reserves upwards.
>
> d. Municipal Bonds. Eliminating the interest deduction will force immediate and severe devaluation of bank bond portfolios, particularly affecting small to medium sized financial institutions. A secondary effect will be to remove the "financial industry" from the tax exempt bond market--a blow to all states, municipalities and those higher educational institutions with bonding authority.

2. Effects on University employees:

a. Health Insurance. Each employee's net disposable income will be reduced if a portion of the employer-paid group health insurance premium is taxed, as proposed by the November, 1984, Treasury Department recommendation.

b. Deferred Compensation. The Treasury proposal to eliminate state deferred compensation programs would increase employees' current tax burdens, reduce net disposable income, and discourage saving. The President's proposal would have no effect on our employees.

c. Life Insurance. The Treasury recommendation to tax the premium value of all group term life insurance would reduce net employee disposable income.

d. Credit Unions. The proposed elimination of the tax exemption for credit unions, as proposed by the Treasury recommendation, could threaten the continued existence of the UI Credit Union.

e. State and Local Tax. Eliminating the deductibility of state and local income taxes and real property taxes, recommended by both proposals, penalizes the higher taxpayer and all homeowners because it subject individuals to a higher federal tax burden on eligible income. Elimination of the real property tax deduction would have a negative effect on the Idaho lumber industry by creating a disincentive for home ownership.

3. Effects on the University of Idaho.

a. Charitable contributions. The Treasury proposal would permit a tax deduction only for contributions which exceed 2% of adjusted gross income, and permits no deduction for unrealized gains on contributed property. Both could reduce donations or bequests to the university. The elimination of the deduction for non-itemizers suggested in the President's proposal would have less effect since the current maximum deduction is only $75.00.

b. Municipal Bonds. Depending on the final wording of this proposal, elimination of tax exempt status for municipal bonds issued for "private purposes" could have an impact on future funding sources for building purposes at the university. This proposal would have a drastic effect on private colleges and universities. Elimination of tax exempt status for municipal bonds will force governmental entities to resort more and more to current tax levies to finance public projects now funded by bonded indebtedness, reducing availability of tax revenues for support of education.

4. Summary and Conclusion. Personal and corporate financial decisions are influenced by tax policy. Changes in tax policy will force different investment decisions to maintain profitability. In a state such as Idaho, whose economy is dependent on capital intensive resource industries, changes in tax laws can significantly affect short term profitability before effects of longer-term benefits to the national economy are felt.

The economy of Idaho has been in a state of stress for the past eight years. Those stresses have taken their toll on the state's higher education institutions. In the long run reduction of the federal deficit would benefit the Idaho economy by reducing interest costs and helping to increase the attractiveness of Idaho products to overseas markets. The proposed adjustments to the tax law do not appear to reduce the federal deficit. Simplification of the tax law is an admirable objective; however, the resultant tax changes should be phased in, if possible, to avoid adverse short term effects on the state's basic industries and individual incomes--taxes on which provide revenues to support state services.

Senator Symms. Is Bud Middlewood here?

Mr. Middlewood. Yes.

Senator Symms. Dave Trail?

Mr. Trail. Here.

Senator Symms. Rick Ingram?

Mr. Ingram. Here.

Senator Symms. You may proceed, Bud.

STATEMENT OF HOWARD B. MIDDLEWOOD, JR., BUSINESS CONSULTANT, DRIFTWOOD CONSULTING SERVICES

Mr. Middlewood. My name is Bud Middlewood, former resort marine owner, small business operation, sole proprietorship and currently a consultant—business consultant. And I think I'm going to take a little different approach. I have a prepared statement, but one of your questions, Senator, indicated that you did not believe the complete impact had been identified on the tax proposal. And I haven't gone through this process before. My question was, that how any business person can identify the impact to all of it until all the changes are developed, spelled out; and once that happens, how to identify the multiple IRS interpretations of the law as translated by the various agencies involved.

The legislative history strongly suggests neither the Senate nor the House is aware of the impact of the laws they pass. Therefore, how can a small business?

I played around with my own computer for awhile, and unfortunately I spent too much time chasing the alligators away to run through each one of the tax proposals and identify how it would affect my family, my personal business. To run through each of the things, when the Congress hasn't really identified what they are going to come up with, is beyond my computer capabilities.

[The prepared statement of Mr. Middlewood follows:]

PREPARED STATEMENT OF HOWARD B. MIDDLEWOOD, JR.

I have talked to Sandy at your Coeur d'Alene office and told her that I did want to be included on the list of persons to comment on the Tax Reform hearing that you are holding in Coeur d'Alene on August 9, 1985.

Based on the various and sundry reports and articles that I have read, "tax reform" is out for this year!

Although various modifications in the tax structure are being proposed, they are far from the basic concept of "tax reform".

Your letter (July 24) made several requests:

(1) You "do not believe the complete impact has been identifed."

Comment: "How can any business person identify 'impact' until the all of the changes are definitely spelled out? And, once that is done, how to identify the mulitude of I.R.S. "interpretations" of the "law" are "translated" through the Courts, "private letters", etc.?

Point: Legislative history strongly suggest that neither the Senate or House are aware of the impact the laws they pass! How can a small business?

Recommendation: Assure that any final bill carries, in the "Legislative History" (not available in your Coeur d'Alene office or in Coeur d'Alene) the intent of Congress when passing the bill.

(2) "...commonly discussed tax proposals..."

Comments: Back to square one! I can run down several pages of tax laws that I would have liked to be changed...but all for my personal benefit. My letter to U.S. News & World Report carried my basic philosphy...require politicians and executives to prepare their own tax reports without benefit of C.P.A.s, accountants, bookkeepers, tax attorneys, etc. Even with a C.P.A. preparing our S-Corp. business taxes for $1100, I prepared my own taxes with 26 separate forms to prepare, with the usual cross references.

The previous depreciation schedule was changed to the new accelerated depreciation...among other things, limiting the period I felt the equipment should last; and setting an "open season" on year end purchases...i.e. "tax avoidance". I'll be honest about it...I bought a truck on December 28, 1984 and took a full year's depreciation and also investment credit for it. No question that the previous law saved me money...but there is somebody out there who'll have to pick up the savings I had!

A current proposal, is to again "revise" the depreciation schedule. Small business comment..."what, again?" Have you ever tried to maintain three sets of depreciation schedules for business equipment purchased, or sold when the laws and regulations change every year or so? I am not talking about businesses that are making enough to employ "experts" at $65 to $500 an hour; I mean the ultra small business with a net income of less than $10,000 for the family!

Another current proposal is to enact a modified "flat tax"...after reading a bunch of stuff...why not? Another small business comment...I spent enough years reading to pretty well know how much I could afford to pay in taxes and if taxes were "too high", all I had to do is start searching for the loopholes. Quite frankly, I aimed at the 15 to 17 percent of income and that has tracked out for more than 10 years for me and several wage earners I know that do report their earnings.

Then there is the proposal to not allow "vacation home interest deductions". Although just a "proposal", the tax advisors, etc. are already developing ways to circumvent the proposal.

Points: (a) Simplify the tax laws and regulations and don't just change them! The small businesses I know, cannot handle more confusion in the tax laws, nor can they afford to pay the fees for "professional avoidance experts"!

(b) Enact a tax reform measure that is "fair" to the ultra small businesses!

(c) The "special interests" are probably farther ahead on circumventing than either I.R.S. or Congress...and probably always will be.

A personal comment Steve; having written several government agency regulations in my former government career, my biggest problem was attempting reconcile Congress' intent and the enacted law. As you well know, a misplaced comma can change the meaning of a paragraph. Regardless of the final laws passed, it is the "intent" of Congress that should be interpreted by regulatory agencies.

Senator SYMMS. Let me ask you a question on that, Bud.

In one of our hearings when the Treasury started to testify on this tax proposal, and they go around to the meetings and let each Senator make a couple comments, some of them make very lengthy comments, but all I said was, I thought the finest piece of tax reform we could give to the American taxpayers at this point is adjourn this committee in the House Ways and Means Committee for 5 years so you can all figure out what happened in the last 5 years. Is that what you are telling me?

Mr. MIDDLEWOOD. I would agree with that.

Senator SYMMS. It's so complicated now. In other words, the thought of having a new burden of changes on top of you and your computer is almost more than you can bear?

Mr. MIDDLEWOOD. I am not a full-time tax adviser. Rick has got some of the same publications I am getting. I made a comment—this went to U.S. News & World Report, if they want tax reform, tax simplification, require the politicians, the local, State, and Federal level to prepare their own tax forms without the benefit of a CPA and tax consultants.

With his corporation, the corporation just paid $1,100 to prepare the corporation taxes. I had 26 pages on my own personal taxes because we sold the business. And the depreciation schedules we are up against. I think this is the third time since I had the business in 1976 that they proposed changing the depreciation schedules again. That makes three separate depreciation schedules that the business has to maintain. Again, my computer won't handle it.

To simplify—let's see—oh, yeah, there is a proposal now that would deny or not allow vacation home interest deductions which would assumably reduce or increase some people's taxes. Well——

Senator SYMMS. That's to be sure, there is nobody left in Idaho that hasn't been touched.

Mr. MIDDLEWOOD. When this publication came out, all the publications were that way, to circumvent this regulation if it became law. It's nothing confusing. It's in one of the statements I have here from one of the research tax issues. I agree, simplify the tax laws and regulations, don't just change them. The small businesses I know and work with cannot handle more confusion in the tax laws, nor can they afford to pay the fees for professional avoidance experts. Sorry, Rick. And I would like to see a tax measure that is fair to the ultra-small businesses. And I am talking about the businesses whose gross income—net income is less than $10,000 a year or basically a family operation.

A special comment, in having spent a few years in Washington, DC, the special interests are probably farther ahead in circumventing the regulations and laws than either the IRS or Congress and probably always will be. Thank you.

Senator SYMMS. Thank you very much. Let's see, Dave, have you a statement here. Would you like to give it, please?

STATEMENT OF DAVID M. TRAIL, CHARTERED FINANCIAL CONSULTANT

Mr. TRAIL. My name is Dave Trail. I am a University of Idaho graduate in business and economics. I have been in the life insurance business for 21 years. I am a chartered life underwriter, have earned my chartered financial consultant degree and have my securities license. My resumé is submitted with the handout material.

I am not here representing any company or trade association. I am here representing my present clients and my future clients who are citizens of the State of Idaho.

First, I thank those responsible for providing me the opportunity to speak today.

I will present a brief overview of the importance of the insurance industry in Idaho, a description of the tax being proposed, and reasons why I feel the proposals are simply a bad idea for my clients.

First, the life insurance industry today provides the following benefits directly to Idaho citizens:

One. $45.8 million per year in death claims.

Two. $162.3 million per year in annuity and insurance benefits paid out. These are self-help programs which obviously help keep people off welfare programs.

Three. $3.2 billion per year in sales of life insurance in our State. About three-fourths of the premium-flow on these sales would be affected by proposed tax changes.

Four. Currently, $17.5 billion of life insurance is in force in Idaho with about 75 percent of the premium-flow representing lifetime or permanent cash value insurance—the type of coverage this tax bill would adversely affect.

Five. There are approximately 11,000 agents licensed in our State, many who depend entirely on the sale of life and annuity products for their living. Agent's secretaries, clerks, and home office employees of Idaho-based companies provide another 4,000 to 5,000 jobs.

Six. My industry currently provides State of Idaho citizens mortgage money in the amount of $264,200,000 for farm mortgages and $289 million in nonfarm mortgages. Together, this one-half billion dollars in capital is without doubt as important to the future favorable progress of our State as fuel is to your automobile.

This may be a surprise to some of you—

Seven. Life insurance premium and annuity tax revenue; that is, paid by the insurance companies directly to the State of Idaho, is Idaho's third largest revenue source in our State budget.

Ladies and gentlemen, we cannot afford to allow a Federal tax law change to disrupt an industry so vitally important to our State. Let me explain—

Original tax proposals called for tax on the cash-value buildup on all existing and future policies of life insurance and annuities. Now, proposals call for old policies already on the books to be grandfathered. But future policies would be involved—so like with Social Security, the next generation is supposed to pay the freight.

Why are we concerned? Social Security is compulsory—buying cash-value life insurance is not.

I'll explain my concerns further:

There are two kinds of life insurance: One, term or terminating insurance; and two, lifetime or permanent cash-value insurance. Both kinds have their place.

My job out in the marketplace is to identify my clients needs, short range and long range. Next, I recommend products to fulfill those needs; that is, short-range needs, short-range term insurance. Long-range needs are covered by level premium permanent lifetime cash-value insurance. The cash values buildup over time on a level premium basis to enable the product to become paid up and to continue for life. These policies always pay a claim. Term insurance is temporary, doesn't build up cash values and becomes exorbitantly costly later in life. Thus, only about 3 percent of term policies ever mature into actual death claims—see exhibit A. Tax reformers want to tax the 97 percent of our policies that do result in actual death claims. These lifetime policies are doing the job; let's leave them alone!

Thus, important to my clients is the recommendation and availability of correct coverage. But if tax laws effectively outlaw cash-value insurance through ridiculous tax laws, an important planning and financial tool to my Idaho clients would disappear.

Accordingly, this portion of the tax law proposal is not fair and it is not simple—the two guidelines for tax proposals this year.

Further, under the proposed law, the income tax cost due each year on a cash-value policy eventually would exceed the annual premium.

This is like taxing the equity buildup in your home each year—even though the actual equity is not constructively received in cash and having to pay a tax cost larger than the house payment.

So, the tax proposal creates an age-indexed tax, a new senior citizen tax. How many people would buy homes with similar adverse tax results?

In summary, why are all these things important to my clients?

One. Many clients require long-term life insurance coverage for their long-range problems. I do not wish to have these lifetime products unfairly taxed out of existence.

Two. Permanent or lifetime insurance provides over one-half billion dollars in capital for our Idaho farmers, homeowners, and business clients. Term insurance provides very little capital formation. Since life insurance is sold, not bought, it is doubtful that the one-half billion dollars of capital would simply find its way back to Idaho through other financial vehicles.

Three. The proposed tax would be substantial and age-indexed.

Four. Low- and middle-income Americans would be hit the hardest. Why? Because over 75 percent of these policies are bought by people with incomes under $25,000 per year.

Five. This proposal represents bad social and tax policy. It would discourage my clients from providing for themselves. They would become more dependent on Government not less dependent.

Six. Congress already revised the life insurance tax law in 1984. Let's let the present law show its intended result before imposing additional changes.

Seven. The tax would be payable even though there is no income constructively received by the policyholder—it's called "phantom" income.

Eight. Since over 500,000 people in Idaho own permanent lifetime cash-value insurance today, this proposal does not apply only to a special interest group.

Nine. Several hundreds or thousands of insurance-related jobs in Idaho can be adversely impacted.

In a nutshell, under the proposal to tax life insurance values, my clients are the losers.

Let Idaho not forget what has happened in our mining industry; let us not forget what is happening in our forest products industry; and, please, let us not destroy yet another industry so vital to Idaho's present and future economy. Thank you for considering my testimony.

[Exhibit A, referred to, follows:]

EXHIBIT A

NEW YORK LIFE REPORTS THAT IN 1983, 79 PERCENT (ALMOST 4 OUT OF 5) DEATH CLAIMS WERE PAID ON PEOPLE OVER AGE 60. ALMOST NO TERM INSURANCE LASTS BEYOND AGE 60, SO ONLY 1.23 PERCENT OF NEW YORK LIFE'S DEATH CLAIMS CAME FROM TERM. IF MATURING ENDOWMENTS ARE COUNTED AS CLAIMS, THE PERCENTAGE OF TERM CLAIMS GOES DOWN STILL FURTHER.

BECAUSE TERM POLICIES HAVE A HIGHER AVERAGE FACE AMOUNT THAN WHOLE LIFE, COMPARE RESULTS ON A DOLLAR BASIS. IN 1982 AT NEW YORK LIFE: 60.5 PERCENT OF THE FACE AMOUNT OF INSURANCE SOLD WAS TERM; 35.0 PERCENT OF THE FACE AMOUNT OF INSURANCE IN FORCE WAS TERM; 13.0 PERCENT OF THE DOLLAR DEATH BENEFITS CAME FROM TERM; BUT ONLY 2.66 PERCENT OF THE TOTAL DOLLAR BENEFITS PAID OUT CAME FROM TERM.

Source: 1984 MDRT Proceedings

Senator SYMMS. Thank you very much, Dave. That is a devastating statement to those people who have promoted what I refer to as a harebrained scheme to tax the inside value of life insurance. But you certainly put it down in a concise method, and I will have that in my hand when this issue comes up in the Senate Finance Committee. And your work is sure appreciated by me in putting it in such a concise statement.

I would like to have you explain for me right in line with your testimony exhibit A.

Mr. TRAIL. The statement on the percentage of insurance to pay claims as far as the types?

Senator SYMMS. Yes.

Mr. TRAIL. Just simply that the example states that New York Life, which is a major company, reported that—the bottom line is the last sentence, that they had 2.66 percent of their total dollar claims paid in 1983, which is an example year, came from term insurance, and simply the fact that most people outlive term insurance, and it terminates before the people do.

Senator SYMMS. The thrust is, as far as the social policy, you are saying this will cause everybody to buy term insurance, and then the death benefits will not be there for clearing up——

Mr. TRAIL. That's right.

Senator SYMMS [continuing]. Problems for those that are left behind?

Mr. TRAIL. Right, because the term insurance for those that wish to continue it into late ages would become—it's just so costly they don't carry it. I don't think I have ever met someone 75 years old that owned term insurance in the last 21 years.

Senator SYMMS. Rick Ingram.

[EDITOR'S NOTE.—The prepared statement of Mr. Ingram was not available for the record at the time of printing the hearings.]

Senator SYMMS. Well, thank you. I appreciate all three of you testifying.

Rip wants to ask you a question.

Mr. RIPLEY. You said we ranked 43d. Now, as I read the table, that's 43d as to income.

Mr. INGRAM. Right.

Mr. RIPLEY. That's not as to taxes?

Mr. INGRAM. Right. I'm sorry if I misquoted. That's 43d as to income.

Senator SYMMS. We will take a 5-minute break right now, and we will start at 15 minutes until 12.

[A brief recess was taken.]

Senator SYMMS. Some of you may make brief statements. We have the open mike. If there are any other witnesses not listed, we will entertain getting your positions made in the record.

Next, is Al Peterson here from the Lewiston Grain Growers?

I guess Mr. Peterson isn't here. If there is a written statement from Al Peterson, we will put it in the record.

At this point now, we will hear from John Burton, who is a farmer who lives not too far from here.

Mr. BURTON. Worley.

Senator SYMMS. Do you have a written statement?

Mr. **Burton**. No; I have not.

Senator **Symms**. We will hear you out.

STATEMENT OF JOHN BURTON, FARMOWNER

Mr. **Burton**. OK, Senator, I will cut this a little short because the time is getting late.

As you know, my name is John Burton. I am a native of Idaho, as my father and grandfather. I am a veteran of the U.S. Army, served 2 years in the Special Forces in Europe. I have served on many commissions and many boards and recently on the Idaho Wheat Commission and Advisory Board of the Idaho State Department of Agriculture.

Again, I am kind of cleaning this thing up a little bit.

I heard many things in the timber industry which are also facing you in agriculture. I realize this hearing is on taxation, but before you can derive any taxes, you have to have a resource. And many of the farmers are losing their resource base, losing their farms.

I enjoy your graphs over here. However, I feel you have two of them that are missing. One should be a graph of the national debt, which is $1.8 trillion, and I believe the other one that should be here is our trade deficit. Last year our trade deficit in the United States was $140 billion. This year it looks like it's going to continue as they are, close to $180 billion.

If you don't have farmers farming, don't have loggers producing, you really don't have a tax base. As Skip White testified, in one timber industry alone—one company, you lost 250 employees. That's 250 immediate employees. But how about the people that sell the cable, the tires, gasoline, et cetera?

I really feel I have been testifying for several years. I have been back in Washington many times testifying. It really doesn't seem like it does much good, because agriculture is in the shape it is today, and it's going to get worse. I guess about the only thing I can really say is, what we are saying is right. I think——

Senator **Symms**. What you are saying is, John, you prefer Congress to reduce the expenditures over and above trying to tamper with the Tax Code and have some profitability return to agriculture?

Mr. **Burton**. Looking at who is controlling our input and who is controlling our growth, when we were back in Washington, we ran into a survey or a study that was put out by the Committee on Governmental Affairs of the U.S. Senate. It was released in 1978. It showed our production needs which led into the grain revolution in the early 1960's. During the green revolution we became very dependent on petroleum. We testified we required big machinery, required more financing, more dollars, and it also made us dependent upon the petroleum, fertilizers, and chemicals. This study has shown the very same people who control all of the petroleum industry controlled the tractor manufacturing, control transportation, also have investments around the globe in many places that we sell our wheat to.

Our Government, like I say, we are running a deficit—deficit spending probably since 1960, but it's increasingly getting worse.

Our Government that buys our wheat does not have the money; so in order to pay the American farmer for the cost of production, we go to our Government and they pay us, and they add it to our national debt. I don't see where that is healthy for anyone.

We also find the corporations, banking institutions, whatever, have factories and whatever in this country, they produce much cheaper and ship it back to the United States. All we are doing is footing the bill here, and that's part of our national debt. But the people with the resources end up paying for this.

Just like here in Coeur d'Alene, Kootenai County, I was talking to a very prominent individual here in the Kootenai County government, very intelligent man. But he said, "Well, I don't really mind paying more taxes." I said, "Well, but you have to remember one thing. One hundred percent of your paycheck is coming from a resource tax place." In other words, he didn't mind paying more taxes; yet his income was out of resources off the man that had the resources, the one buying the service.

Just like I heard this morning, the timber industry, mining resource people, they can't make it any longer. Their production costs are just exceeding what they are receiving for the goods they are producing and so on. I really think what we are going to have to do, I think this is good, we have to go around here and see whether or not—if the economy can't generate more taxes. I don't believe it can.

The agricultural debt just in the last 10 years, the debt went from $60 to $218 billion for what we are producing off of agriculture nationwide. It's just much like the national debt. If we have a $1.8 trillion national debt, that requires $180 billion in interest alone just to service that debt.

Go back to the individual I was talking about here in Coeur d'Alene, he works for the government, he is willing to pay more taxes, but his paycheck again depends on me or the timber guy, and we can't afford any more taxes. We would probably end up losing our land just like Terry Sverdsten, he lost his family lifetime logging operation.

So, I think basically I will wind this thing down. One thing I would like to see the Members of Congress do is probably follow what a former colleague did, Ron Paul, to try to promote in the United States, check on the Federal Reserve System so that we get this money thing straightened out so we can go ahead and produce and pay our taxes and get this country back in a civilized society. Thank you.

Senator SYMMS. Thank you very much, John.

Any questions?

Mr. RIPLEY. No.

Senator SYMMS. With respect to agricultural taxation, I will just ask you one question.

I guess essentially when a wheat farmer in a situation he is in right now, taxes are the least of their——

Mr. BURTON. I am not worried about taxes. I don't have to pay any. You have to make money to pay taxes.

Senator SYMMS. So, some of the things that the farmers are going to lose, as far as I can see, grain farmers—every grain farmer I talked to, anybody farming on the high-lift pumping project in southern Idaho, are having a tough time also, and mostly the specialized type farmers that are still making a profit, produce farm, potatoes, onions, and seed farmers, some of them, but a lack of profitability, so taxes aren't a big problem with them. But international trade is a big problem, and the deficit is a big problem, and the long-term future, of course, is critical. So you would concur, then, what the Congress ought to do is to work on those things we can do something about that would have a lasting impact, reducing Government expenditures, get the trade deficit working so to where we can export before we worry about the tax reform.

Mr. BURTON. I think so, too. We all have to be a little careful when we address the farmers, because while the independent family farmer is on the way out, we do have the corporations moving in and taking over the farms. When I say corporations, Prudential Life Insurance, Exxon, et cetera, et cetera. When you go back to the books and see the principal stockholders, they are the corporations basically, they are banks, a handful of New York banks. We hear about the Government subsidies and, yes, I think some of the subsidies are very unfair. But they are going to these corporate-type farmers. We can even go further; while over the years the grain revolution provided us with production needs essentially, they also have been running money through another organization. So, while we are pretty much tied to them, they also are moving in and taking over the land.

This is the old conservative philosophy. This bothers me somewhat with this new conservative Congress back there; there was always a fear, and I think a rightful fear, that possibly a handful of the few bankers would probably end up owning most of the resources in the United States, but not only in the United States but the globe as well. It comes down to a monitoring system, basically, of the Federal Reserve System. I know many times we hear politicians talk about a big problem that the Government has in printing presses going. But in reality, the Federal Reserve is an independent organization. And this is what Ron Paul, and he is a liberal, and Henry Gonzalez, sit there all day long, and at the end of the session he was addressing it, too. You really wonder why more congressional Members have this problem. I think it is our problem. And I think people are losing their lifetime earnings just basically through the monetary system.

Senator SYMMS. Thank you very much.

The next witness is Mike Krapfl. Is Mike Krapfl here? I guess he is not here.

Fred Walker. Come on up, Fred. Welcome to the hearing.

STATEMENT OF FRED WALKER

Mr. WALKER. Thank you. I am not used to any of this, talking going on like this.

Senator SYMMS. Just relax.

Mr. WALKER. I mean to.

What I want to address is the fact that, being a worker, I follow construction work. I travel. My work causes me to travel all over, so I do not work at home.

What I find throughout my traveling and a lot of the fellow workers in the same position, my first thought is, Senator, if you are going to do a tax reform, you really need to take a week's time and burn all the old tax stuff that you've got and start over new, at least write it so an eighth grader can understand it and everybody can interpret the same. What you got now is a matter of harassment, because I doubt if you can take any—take 10 of our tax people in the Internal Revenue and take part of their rules they got and ask them to rule on it, I doubt you will come up with the same ruling out of any of them. How is an individual supposed to come up with it? I have been down this road. They audited me, wanted to audit me, so I walked in with all my stuff to talk to the man. I took my recorder along, and he wouldn't talk with me. He refused several times. I ended up going clear to the court with it. I hired the lawyer at $100 an hour. Now, that adds up pretty fast. We sat in the courtroom paying $100 an hour while the judge went through all the people there trying to decide whether they should be in court or whether they shouldn't, what reasons they was there. The biggest percent of them I seen was there was over their expenses, was why they were being challenged.

It's very interesting to note that all the Internal Revenue people with their lawyers were wearing blue pinstriped suits. I commented about this. And my lawyer says, "Well, it's a known fact that if you dress in blue, you are thought to be more believable than if you are dressed in any other color."

Senator **Symms**. I would be right in order, then.

Mr. **Walker**. I am not. But, anyway, the judge stated right to one of them that was up there talking, he stated right in the fact that on expenses that it states right there in the rules that the day—the minute you leave the State or the city limits, you have left your home. Yet, when they—I am sure you are familiar with their procedures. Rather than having you in court, they like to—they have an auditor there to try to see if they can settle out of court before you go in. Yet, she wanted to disallow the fact that when I left the city limits of Coeur d'Alene, which has been my home since 1956, that I had left home. And yet the judge ruled right there in the court. So, this shows that inconsistency that you have.

Now, to go a little further on this, every time you get your tax return back, if you receive more than $200 back in your return, they send you this great little card that says that you should revise your deductions, because you are receiving too much back.

So, now you revise your deductions on your next job and raise it up so to counteract so you try to get so you are not getting over $500 back. And you get this nasty little letter from some other part of the Internal Revenue that says send us all this information like another tax form, and we'll decide whether you are entitled to this or not. And if you don't do it, well, they declare you as a single and inform your employer to do this.

Now, this becomes harassment in anybody's book. First, they don't want—they want to make sure that you're not having too much withheld, and then they turn around and tell you if you do try to do that, why we are going to have you—we are going to tell you what you are going to take out. So, you got a consistent fight, battle of harassment going on.

At times you maybe ought to look at something else. You know more than I do about how many States has got a sales tax. And every one of them has got it wrote out and spelled out what is deductible, what isn't, how it works. So, like for instance loggers, his chain saw is tax free when he buys a chain saw, because he is out there making a living with it. So, you got this all spelled out.

Why can't our Federal Government gather in all of them from each State, look them over and set up a fair sales tax setup so that then you do not have to keep a million pieces of record, because not everybody is a paper pusher.

Now, when I do all this paperwork that they are requiring me now, my family just as well may leave home, because I am not worth living with. I can tell you right now I become an absolute bear. I get so mad, I can't even stand myself. And I'm not kidding you. It's absolutely that way.

What do they require? You have got to take every meal ticket, you have to save that. It has to be initialed by the waitress, or whoever took your money, it has to have the restaurant's name on it, you have to have the date.

Have you went around and looked at how many restaurants that use just the regular old—go down to the dimestore and buy receipts? If you are not on your toes, you ain't going to ever get one signed, and have their name on it. And they don't want it in your handwriting, because they say anybody can go down and buy a receipt book. So, if it hasn't got that, it's not valid.

Yet, they turn around and tell you that you can have—you can declare it without these receipts, but they allow you $9 a day to eat. Did you ever try to go out on $9 a day and eat and work? I hope to smile. You are lucky if you get breakfast for $4. And lunch and a thermos bottle of coffee costs you $4 to $5. Where are you going to go with supper? There is a lot there that's got to be thought about, talking about the workingman.

Senator **Symms**. From the workingman's point of view, would you like to have a Tax Code that, when you got ready to fill out your income tax, you would have about three entries, one to list the total wages and income for the year, any interest income wouldn't count, it would just be income from wages, and then have a deduction for how many members there are in your family, say $2,000 apiece, and then have a flat rate on everything else so you could do it on a postcard?

Mr. **Walker**. What I would rather have—you are asking me what I would rather have. I would rather have a straight Federal income tax that I could regulate how much I spend, how much I have to pay, because if I decide that I want a new car, I can decide whether I want to pay the taxes on a Cadillac, or I can pay the taxes on a used car.

Senator **Symms**. You mean administrate a Federal sales tax?

Mr. **Walker**. I mean a Federal sales tax, yes, that goes right through, then, and the Federal Government pays the storeowner say one-half of 1 percent of the taxes that he collects for his expenses of bookkeeping, because he is going to have to do a little more bookkeeping; so it's not fair to put it on him without getting reimbursed. That's what I would rather have.

As far as the others monkeying around, I think all of this business that you got, nobody can determine what you are supposed to have and can't have. It's time it's been done. They have absolutely took the honor out of this country with the setup they got now. If you try to be honest, they take you to court and call you a liar.

Jim Casey is now passed away, not a finer gentleman in the world, an old logger. Every year they audited him, because he was not a bookkeeper.

One year when he was working for Ohio Match, the bookkeeper says, "Jim, why don't you let me do your books for you?" He did him a beautiful set of books. They audited him. He brought in the books, and the Internal Revenue man looks at them, and he says, "I don't know what we are doing with any of this." He was never audited again, because he had 1 year he got somebody that could do the books and did him a beautiful job.

Now, this gets to be ridiculous. It shows if you have a good bookkeeper, you can get away with all you want to get away with. But if you try to be honest and not have a bookkeeper, you are audited and harassed all your life.

To be honest with you, I got down nowhere I declare—I know what my expenses are. I declare the deductions that I think it will take to be OK, so that I pay my taxes and pay a little extra, and I have quit figuring your income tax entirely, because the harassment is a lot less. I don't have the mad spells I have to go through when I am doing the bookwork. I don't think it's fair that this country should put that kind of a burden on an individual. If you are going to go Communist all the way, why don't you make it a requirement that every man and woman has to go out and do mechanical work on the Federal Government cars 3 days a week or a month and make it a law, if they don't do it, you will take their home away from them, or you will go to jail, or imprisonment or fine just like you have with this Federal bookwork you have here with your Internal Revenue setup.

Senator SYMMS. I am very glad to hear your testimony this morning. You, I think, represent those taxpayers and citizens in this State that are exactly the same—I run into people that have that same problem everywhere. And I guess this has been my frustration over this entire effort that the President has made for tax reform, because I think when he gives his speech on television about tax reform, I hear it, and I say, "That's what I would like to have, a simple, fair, equitable tax system."

Then when I look at the bill that the Treasury people write and send over to the Congress, it's a continuation of the same complicated system. Your point about burning up all the current regulations is exactly right. You have to start over.

Mr. WALKER. Look at one thing. Excuse me for interrupting. Let's look at it one way. You had a problem with the air controllers. He fired all of them. They got the job done with less controllers and did a better job. Why don't they do that with the Internal Revenue? You are wanting to balance your books. Balance the budget.

Senator SYMMS. Let the record show the audience applauded that.

Mr. WALKER. Isn't that the biggest department you've got?

Senator SYMMS. It's a big department. There is a lot of harassment, and I am concerned with your viewpoint. The frustrations are highly—it's much more frustration than people should have to put up with for the tax system.

The problem I see with the current Treasury tax proposal, we refer to it as the President's tax proposal. I am not sure that's quite fair to say, because it was written by all the people in the Treasury long before he got there and intends to be there long after he leaves, and I just believe—I think there is a high moral ground of tax reform along the line you were talking about, either a simple sales tax nationwide, or the bill that Senator Dirksen and I introduced, which is the flat tax, that makes it so it's a very simple postcard type, even for a wiser individual to fill out, a postcard to file their tax return at a much lower tax rate but you remove the deductions. But those ideas are not on the forefront of the burner. The current Treasury proposal that the President has been talking about still will not remove you from that complication that you have when you are traveling and trying to keep track of your records. It's not going to solve that problem.

What you are saying to me as a workingman, taxpayer, make it so that it's simple, and you know what you are paying?

Mr. WALKER. That's right. The part of it is, you take out and make a sales tax, is the most fair and honest tax you can get because the plan, no way he can lie about it, and he knows when he is going to buy something, he is going to pay the tax that's there. And he's got a chance, like I say, he can regulate his own tax, because he decides whether he wants to buy that or buy expensive, buy lower.

I do believe that there does need to be an exemption of food. That is something that everybody has to have, I don't care how old you are or how young you are. I think the tax should be left off of food. I think that has to be left off of housing, which is something everybody needs, but of course you have to put a limitation on that because luxury houses—now, somebody living up in luxury, that's something different. But you have to figure it on the basis of what is a basic shelter that everybody has to have. And everybody has to have utilities. You've got to be able to heat in the winter in order to live, and some places, I understand, are hot enough you need some way to keep cool. That has to be taken into consideration.

But, like I say, you already got so many States that are already working with the sales tax, there is no reason why the Federal Government can't gather them all in and go through them and come up with a workable plan that everybody can live with, and you won't be running taxation on taxation. And right now you've got that.

Senator SYMMS. I thank you very much. It was great testimony. Any further witnesses that are here that want to testify?

Mr. HUNTER. I am Mr. Hunter, pastor of the Coeur d'Alene Church of the Nazarene.

Senator SYMMS. Do you have a prepared statement?

Mr. HUNTER. No; I don't have a prepared statement.

Senator SYMMS. Go ahead, Mr. Hunter.

STATEMENT OF REVEREND HUNTER, PASTOR, COEUR D'ALENE CHURCH OF THE NAZARENE

Mr. HUNTER. As I sat here and listened this morning, I really appreciated what I heard and sensed. And I would just say that my own feeling is in concurrence with what has been said, don't kill the golden goose. We have to go out and round up entrepreneurs. We have to have the entrepreneurs or we won't have jobs. That's really where our tax base comes from. So, if we can get taxes that don't punish the entrepreneurs, the businessman, but allow him to—I was just down visiting Harrah's Club in Reno, the collection of cars they have down there. I am surprised at how many people made cars in this country. We are not doing that today. We are letting specialists do it. Maybe we have to get back the entrepreneurs to do it.

As we look at what you call the uncontrollable spending or entitlement programs——

Senator SYMMS. I don't like to use the term "uncontrollable." Everything Congress grants, they have the authority.

Mr. HUNTER. I am glad to hear you say that. I am a pastor of a church. And while I'm relatively new to Idaho now, I have been here 2 years in Coeur d'Alene, I was born here. But in church work we take care of a lot of people and a lot of specific needs. We helped a lady recently, and because we as a church helped her, there were some negative factors that happened in the Food Stamp Program and some of the other helps that she was trying to get.

I would like to say to you, please give us back the social programs, not to the churches but to the people. People can organize anything they want to, but give us back the social programs. I think that we will take care of poor people, but when we as people take care of the poor in our community, there will be some accountability. That is an important dimension. It doesn't take a whole lot of overhead for us to administer the helps. But we do look each other in the eye as we help those that are needy.

The Salvation Army has done an excellent job feeding people, and perhaps we could keep people from starving to death in the country with a bean line. If you don't like beans for breakfast, lunch, and dinner, you could go out and work for a steak.

But let the people have the programs back.

Jesus said the poor are always with you. And I have been kind of interested in some of the shots recently of the poor lined up—having lived in this country where they are lined up. And I am always amused, the poor people in this country are well fed and well clothed. There is such a thing as poverty. And I think that we as people can keep others from being extremely poor to the point of being critical.

I worked with a lot of people in the health care line. I visit people in the hospital. I am with people who are dying constantly. And I think that in this country we are buying more than we can afford with health care, and we are trying to underwrite that with taxes largely.

I believe that there is and can be a dignity in death. And it's not fair for us to tax ourselves in trying to buy some form of eternal life.

You mentioned privatizing agencies. I worked under the shadow of the Grand Coulee Dam for years and watched a lot of waste. I believe that Government agencies could be privatized and could save us a lot of money if we would spell out the standards, the expectations, and administer the programs not from a Federal level but administer it from a local level. Let's let people who are in the community determine whether it's efficiently run and whether it is fair and equitable.

I really appreciate you coming, listening, sharing yourself with us. Thank you, Senator.

Senator SYMMS. Thank you very much for your statement. Ed Nettleton, a forester from Sandpoint.

STATEMENT OF ED NETTLETON, FORESTER, SANDPOINT, ID

Mr. NETTLETON. I had a little problem hearing some of the first speakers. Can you hear me back here?

I don't really have a lot to say, Steve, if I can be on this familiar a standing with you. I have known Steve for a long time.

Ladies and gentlemen, I am Ed Nettleton. I was born in Coeur d'Alene, ID, raised here, and lived here for a good many years, made a living here. The last—since 1950, I have lived in Sandpoint, ID, Boundary County. I have been on a few of the so-called tax supported entities such as the independent highway district, and so on and so forth. And I think that in all fairness, picking on the Federal Government is justifiable in a lot of instances, but I think that in too many instances it's sort of taken for granted that it's a tax-supported entity and, consequently, there is no independence to it. They keep on raising taxes regardless.

For example, I bought a home in 1959 and 1960 in Sandpoint, ID. I paid $23,000 for it. I improved it a little bit, and my taxes have almost doubled. And they are still going up. And through our courthouse—and it isn't all the courthouse, it isn't all their fault—I think the special leaders and realty people have had quite a bearing on this. They've got it up now where I am paying taxes on a $54,000 fair market home, and where it's going to stop, I don't know.

I want to touch a little on the lumber industry. I was in Canada two different times. Yes; we were guilty of inequality, I guess you would call it. We shipped lumber down here. I went to Kamloops in 1946 and worked for a company that started here in the United States. And why I did go up there, and why they are there, to make money. And it's quite simple, that Canada has had some privileges over and above the people in the United States in regard to their lumber, and I think that we are on the right track today. You people are trying to get some equality to this tariff.

I can be specific. In 1954, 1955, 1956, I was back up in Canada again the second time. And I shipped lumber down here for 50 cents a thousand board-feet, and they took some lumber from Idaho back up across the line, and we paid $32 a thousand board-feet for that.

Senator SYMMS. Fifty cents coming this way, and $32 going that way?

Mr. NETTLETON. Yes; I think that our Government, the Federal Forest Service, all the rest of them, have to be quite guilty along these lines. I worked with the Forest Service 10 years before I went into private industry. And we was self-supporting. In fact, you made money a few years back. The last few years—and this is hearsay. I can't justify it. But I am going to state that it cost the taxpayers money now to support the Forest Service. They were self-supporting. Maybe you can answer that, Steve. But I think there's—what I am trying to say is that a few years back they were selling timber, enough of it, and it was reasonable enough so these loggers could live with it and buy stumpage. And the last few years, that's gotten pretty much out of hand I think.

One little remark on the schools. And we just had a bond presented in Bonner County for $15 million to build some new schools and improve them. And it didn't pass. And I was guilty of putting an article in the paper and voting no on it. I think that our children and our grandchildren, great-grandchildren, which I have some now, should have a good education. And I think maybe 30, 40, 50 years ago, we had a good public educational system. Today I am very critical of it.

I read a book. I have it from a retired professor. He's been on TV quite frequently here in the last few days, Herbert I. London. And the book is "Why Are We Lying To Our Children?" When you read that book, that sizes up what's going on. It makes a lot of sense. We put out children—here I will talk about my own relations so I won't be stepping on somebody else's toes.

A youngster a few years back graduated from Coeur d'Alene High School, and he couldn't fill out—couldn't pass the IQ test to get into the Army. He graduated from the high school system in Coeur d'Alene, ID.

We have two large buildings over here on the 800 block on Seventh Street with the windows boarded up, which were condemned 25 years ago. My wife graduated there 31 years ago, and I can take pleasure in saying she isn't completely—I was going to say dumb. She is educated. And now we've condemned these buildings to show you—relative to taxation is what I am trying to get at. They built two new high schools, and they are still in trouble with their school system in Kootenai County. I think that it's just ridiculous. Those two buildings, by the way, I forget what year it was, but just a few years back they brought in two certified structural engineers and I quote:

> The buildings, from a safety standpoint, structural standpoint, are as good as the day they were built.

And still we haven't been holding school in these buildings. I think something has to be done along that line.

Last but not least, I was down in Biloxi, MS, last year with my daughter. My daughter lives there. Right across the bay about one-half mile is the Batista Air Base. Almost daily, at least once a week and sometimes two or three times a week we had the critics, environmentalists, whatever you want to call them, with articles in the local paper stating "that terrible noise," the environmentalists can't put up with this and all this. And I think in all fairness to the big percentage of us people, I think we are the majority yet that would look up with a smile on our face and say, "Thank God you are there." I think we should have a strong defense, and we need money for a strong defense. If the costs through improper management, or whatever you want to call it, $75 for a hammer that you can go down and buy for $10, that should be stopped. I think there is a lot of things that should be corrected, and I hope they will be under this administration.

We came quite a little ways. We got a reduction in taxes, and I think there is room for a lot more to be done along these lines.

I thank you for this privilege of talking to you, and I hope and pray that we someday get back to better standards and less waste of our tax money.

I believe in this flat rate that you are talking about, and I think it's time that we do something. And the silent majority has got to speak out and be heard and get us back on the right track. Thank you. God bless you all.

Senator SYMMS. Thank you. Mr. Kern.

STATEMENT OF JIM KERN, FIREMAN

Mr. KERN. One of the items I would call to your attention is that there is a proposed 20-percent excise tax——

Senator SYMMS. Note for the record, firefighting is not without risk, and our witness has a broken foot there.

Mr. KERN. There is a 20-percent proposed excise tax on all pensions that would be received prior to age 59½. Firefighters and policemen quite frequently receive pensions prior to age 59½ as opposed to people in other normal occupations. This would be on say a $20,000 pension, this would be $4,000 a year over and above taxation; an excise tax would be placed on my pension; and if I retired at the not normal pension age of 55, I would pay for 4½ years $4,000 a year more, over and above the normal taxes which would be placed on my pension in the normal course of things. I think here again, this is double taxation. And if we are going to exclude people like veterans and Social Security disability pension, we should be looking at some other pensions, perhaps the policemen, firefighters, and paramedics.

Right now when I receive my paycheck, they tax my paycheck as income, and they withhold—in my case 6 percent of my salary goes into my pension fund. When I retire, that money is not taxed until I receive back the amount of money that has been contributed by myself.

The proposal now is to tax me twice, tax that money going in and tax that money coming out. And I think that's double taxation on one income. That money hasn't earned any interest; it's just used by the pension fund, which is invested, which does earn interest, but that part of the money over and above my own personal contributions would be taxed when I receive it under the normal tax laws as they are now.

I disagree with throwing away the whole system, and I can't see that happening in this country if we simply modify what is happening.

I would be taxed double for approximately $30,000 to $40,000 income, which I would pay in over a 20- to 25-year period. That would be like taxation of a job-related disability payment, a tax program calling for taxing all job-related workman's compensation.

I guess dealing with money, we are dealing with things on paper, and maybe it doesn't make any difference whether you tax it or don't tax it. The very proposal, I think, would simply result in higher taxes for people on a local level. The purpose of a disability pension in particular in areas such as police officers and firefighters, the purpose of that pension is to provide an ongoing living of a livable wage to a policeman, firefighter, or his widow or orphans. In order to get people to run inside burning buildings and stand in front of people who have guns, you have to provide them with security that, when or if they become injured in the line of duty, they themselves or their widows or orphans can be economically provided for.

So, if the Reagan tax proposal wants to start reducing my potential pension by taxing a disability payment, you are simply going to require the local city I work for to increase my benefits in some other way by more taxes on local business, more taxes on the local level. It's a ridiculous proposal.

In the handout you gave us this morning on page 3, it says at the very bottom that the unemployment and disability pension, with the exception of the veteran's disability pension payments, would be taxed as income.

On page 4 of the thing you gave us on the other side, it says in view of America's special obligations to Social Security benefits and disabled veterans, the current preference on disability earnings is to be retained. I would submit, Senator, perhaps firemen and police officers ought to be included in that. And maybe there are other workers that ought to be included in that, also.

When this country established the Social Security system, it basically said that related to people who work for wages, but if you are under a system which pays greater benefits than the Social Security system, it was not necessary to put you under the Social Security system.

Most police departments and fire departments throughout the United States are not covered by Social Security. This proposal to force us into a Social Security system would be a reduction in benefits to police officers and firefighters throughout the Nation. All of our pensions are indeed granting us higher benefits than the average Social Security pension simply because we need to offer a little bit greater incentive to people to take this high-risk job.

The fifth item on my list here this morning is taxation of health care benefits. Although it's not specifically outlined for police officers or firefighters, I believe that health care benefits in this Nation are provided to the American worker to make him a better worker, make him healthier and productive, and to relieve any anxiety or burden from having to take second jobs, work night jobs, or to go into bankruptcy because of health care costs. The trend in America has been to provide the American labor force with health care benefits in such a way without getting into socialism, without getting into an English-type system, provide us where we could provide for health care for ourselves and family so we grow up and be productive workers. Taxation of our health care benefits, I think, is counterproductive. We ought to be taxing free martini lunches and taxing vacations and things of that nature that other segments of the work force perhaps enjoy. A person on a fixed income working for the Government or private industry that receives a W-2 form at the end of the year and doesn't have the benefit of adding expense accounts and things of that nature doesn't enjoy that. And I think health care benefits should be excluded from taxation.

Senator SYMMS. On that point, Jim, several of us on the committee talked to the Treasury about that earlier, and we didn't think that they should include it in the bill. And they have changed it now to where they tax the first $10 a month, which goes out a little bit backward. If you want to try to limit how much payments are in fringe benefits, then this would not have any effect; just the first $10 a month of benefits.

Do you think that is acceptable, or would you want to do away with that? It would be $120 a year on anybody's income that had health benefits.

Mr. KERN. That certainly wouldn't put me in the poorhouse, and I don't know——

Senator SYMMS. That is a compromise, I think, the Treasury has agreed to.

Mr. KERN. The principle of taxing health care benefits to the American worker is wrong in basis.

Senator SYMMS. Thank you all very much. I appreciate your statements. It contributed to our record.

If there are no further witnesses, the subcommittee stands in recess until Monday in Boise. Then we'll have a following hearing in Idaho Falls on Tuesday. Thank you all very much.

[Thereupon, the subcommittee recessed, to reconvene at 9:30 a.m., Monday, August 12, 1985.]

[The following information was subsequently supplied for the record:]

ASSOCIATED CALIFORNIA LOGGERS
555 CAPITOL MALL, SUITE 745 SACRAMENTO, CALIFORNIA 95814
(916) 441-7940

OFFICERS
President
Phil Shuster
Willits
Vice President
Brooks Mitchell
Loyalton
Secretary-Treasurer
Dan Smith
Quincy
Executive Director
Ed Ehlers
Sacramento

BOARD OF DIRECTORS
Mike Anderson
Ft. Bragg
Jim Bamford
Challenge
Larry Burch
Westport
Hale Charlton
Quincy
Ed Lewis
Redcrest
Thomas Lyall
Rio Dell
Keith McCollum
Redding
Joe Martin
Sonora
Merle Okerstrom
Ft. Bragg
Warren Raddatz
Clovis
Lowell Robinson
Grass Valley
Clarence Rose
Weaverville
Robert Sauer
Grass Valley
Glenn Schirmann
McKinleyville
Gordon Tosten
Miranda
Bert Townshend
Oroville

July 11, 1985

Congressman Gene Chappie
US House of Representatives
Washington, D.C. 20515

Dear Gene:

Our association of family-owned logging businesses has been watching the news reports of various tax simplification proposals and would like to offer some information which we hope will lead to the adoption of a proposal that not only simplifies the tax system, but is fair. By most standards our businesses are small, capital intensive, and a source of basic employment in the rural counties of California in which we live and work. Collectively we employ about 8,000 employees throughout the state, operate about $400 million worth of logging equipment, and harvest most of the 3.5 billion board feet of timber logged in California each year.

As you may be aware, the timber industry in California, including logging, is much like that in the other western states in that we are still working toward recovery from the recession that commenced in 1979. How we have been fairing is summarized in Exhibit I which tracks the virtually flat curve of logging prices during a period in which stumpage prices (the value of the tree at the time it was cut) have been declining. The essence is that as lumber prices have declined, forcing stumpage prices down, it has dimmed our hope that the market would support more realistic logging prices. Interestingly, during the charted period, the Consumer Price Index has gone up 37%, further complicating our survival effort. Suffice to say, we are faced with equipment replacement needs and operational cash flow needs that are difficult to achieve and maintain in the face of a market impacted by Canadian imports, the strong dollar, and a variety of other elements, such as dramatically increasing insurance rates over which we have little or no control.

Reflecting on the reports we have read on tax simplification we felt it appeared necessary to inform Congress and the Administration of some of the impacts of federal taxation on our businesses so any final proposals could consider our predicament and accomodate our needs. Although it is difficult at this point to tell what shape final proposals will take we have prepared two examples of how federal taxes currently impact our businesses. To illustrate how changing various elements affects the tax impact we have compared each example with the proposal made by the President on May 28, 1985.

Examples represent a small logger operating as an individual and a larger logger who has incorporated. The amounts shown are taken from one or more tax returns of similar sized operations to protect the privacy of the loggers who provided the information but can be considered as typical of such loggers in California.

The most influential elements are depreciation schedules, investment tax credit, and state income tax deductibility. As you can see, even when off-set by rate reductions, modification of these elements creates rather dramatic effects as based on the same income, the tax liability of the individual is increased by more than $16,000 and the incorporated logger by more than $60,000. Obviously such a modification of these three key features diverts money away from equipment purchase and replacement and other operating needs, and into tax payments. It is likely that such a dramatic change will make it difficult to survive and will force operations to cease as equipment becomes unservicable.

If the ultimate wisdom is that broadly based investment tax credit and depreciation schedules are not an appropriate way to provide a foundation for capital investment, then an alternate set of changes will be necessary for our logging businesses to survive.

It seems to us that until the several market factors can be corrected that currently are depressing domestic lumber prices (and hence logging prices), the federal government should join us in our commitment to maintain logging's productive capacity and economic support of our rural areas. To do this, tax simplification cannot result in increased tax payments. For logging businesses increases only draw money from equipment and operations because the market does not now and is not likely in the foreseeable future to be good enough to pass such increases on to others. The money made available by investment tax credits, current depreciation schedules and income tax deductibility is the foundation of our capital investment program. If they are no longer acceptable mechanisms, then comparable substitutes are needed.

We are willing to provide any further information or help that will maintain an adequate capital foundation while tax laws are simplified.

Sincerely,

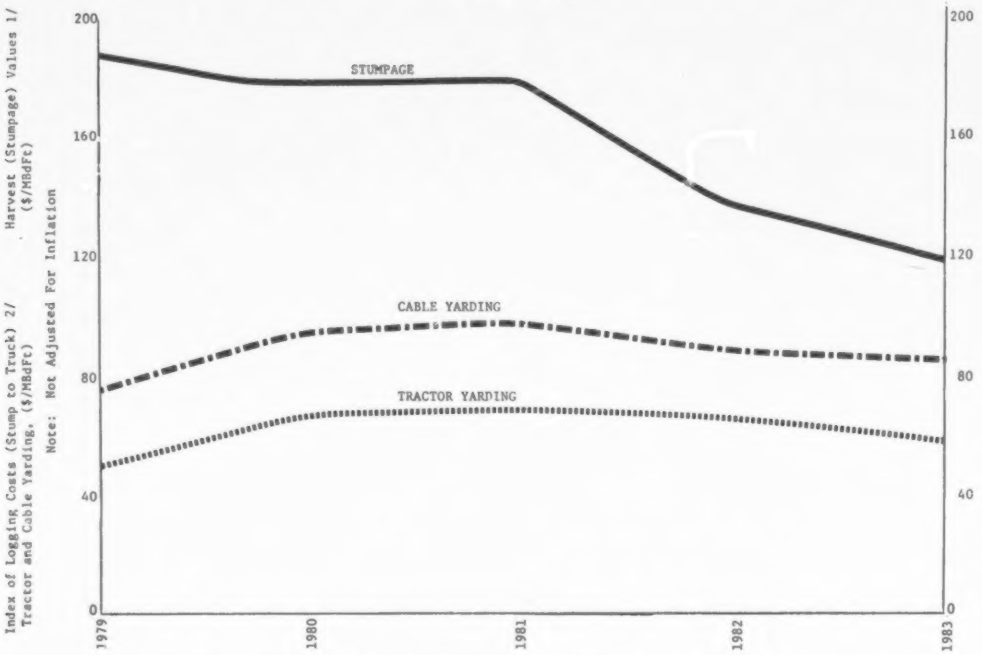
Ed Ehlers
Executive Director

EE:dp

EXHIBIT I

SELECTED ECONOMIC INDICATORS

1979 - 1983



1/ Source: State Board of Equalization 2/ Source: State Board of Equilization/USFS

64

EXHIBIT II

SMALL LOGGER FILING AS AN INDIVIDUAL

(not incorporated, using Schedule C)

Salaries, Interest, Dividends and Miscellaneous Income	41,833.00	41,833.00
Income Schedule C	17,685.00	38,272.00 *1
Less IPA	(4,000.00)	(4,000.00)
Adjusted Gross Income	55,518.00	69,894.00
Itemized Deducts	(6,211.00)	(3,190.00) *2
Less 2 Exemptions	(2,000.00)	(4,000.00) *3
Taxable Income	47,307.00	68,915.00
Income Tax	9,909.00	14,329.00
Less ITC	9,909.00	0.00 *4
Self Employment Tax	1,998.00	4,271.00 *5
Recapture ITC	2,931.00	2,931.00
TOTAL TAXES	4,929.00	21,531.00

*1 - See Schedule #1
*2 - See Schedule #2
*3 - See Schedule #3
*4 - See Schedule #4
*5 - See Schedule #5

SCHEDULE #1

Assets acquired in 1984 under ACRS

Description	Date	Cost	Depreciation
Welder	1/21/84	4,340	651.00
Used Cat Grader	4/06/84	19,636	2,945.00
Shop	8/13/84	55,900	1,118.00
New Tractor	12/12/84	131,970	19,796.00
Total depreciations on newly acquired assets			24,510.00
Other depreciation - unchanged			16,886.00
TOTAL DEPRECIATION			41,396.00

Assets acquired in 1984 under CCRS

Description	Date	Cost	Depreciation
Welder	1/21/84	4,340	687.00
Used Cat Grader	4/06/84	19,636	2,041.00
Shop	8/13/84	55,900	324.00
New Tractor	12/12/84	131,970	871.00
Total depreciations on newly acquired assets			3,923.00
Other depreciations - unchanged			16,886.00
TOTAL DEPRECIATION			20,809.00

SCHEDULE #2

Itemized deduction decreased $3,021 due to non-eligible State income taxes.

SCHEDULE #3

Personal exemption increased from $1000 to $2000 each

SCHEDULE #4

Investment Tax credit no longer applicable

SCHEDULE #5

Self-employed tax increase due to increase in Schedule C income

EXHIBIT III

LARGER LOGGER WHO HAS INCORPORATED

	1984	Proposed 1986
Corporate Income before Depreciation and State Income Taxes	575,804.00	575,804.00
Depreciation Expense	(242,871.00)	(200,992.00)*
State Income Taxes	(26,418.00)	0.00 **
Taxable Income	306,515.00	374,812.00
Income Tax	120,747.00	123,688.00
Less ITC	(58,849.00)	0.00
TOTAL TAX:	61,898.00	123,688.00

*See Schedule #1

**Deduction Disallowed

SCHEDULE #1

Assets acquired in 1984 under CCRS

Description	Date	Cost	Depreciation
PU	7/25/84	3,500	443
Truck	4/17/84	9,540	1,118
Grader	5/10/84	15,900	4,164
Loader	6/13/84	45,000	4,010
Carriage	10/10/84	48,500	1,681
Log Equip.	12/06/84	323,300	4,268
PU	12/31/84	13,987	308
Car	4/02/84	119,747	15,609
Log Equip.	4/01/84	16,000	11,707
			43,308
Prior Depreciation unchanged -			157,684
			200,992
Total as claimed under ACRS -			242,871
Difference -			41,879

THE IMPACT OF THE PRESIDENT'S TAX PROPOSAL ON THE MINING, TIMBER, AND AGRICULTURE INDUSTRY

MONDAY, AUGUST 12, 1985

Congress of the United States,
Subcommittee on Monetary and Fiscal Policy
of the Joint Economic Committee,
Washington, DC.

The subcommittee met, pursuant to recess, at 9:30 a.m., in the Gold Room, the Capitol Building, Boise, ID, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms and Representative Craig.

Also present: Joe Cobb, committee professional staff member; and Dwight Ripley, tax legislative assistant, and Glen Youngblood, legislative assistant, Senator Symms' staff.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator Symms. Good morning. I want to welcome all of the citizens that are here this morning for this hearing and welcome all of the witnesses that will be testifying.

I see my colleague in the House, Congressman Larry Craig is here, and we welcome him.

Larry, come right on up and have a seat.

I have called these hearings on the impact of the tax reform proposals on the economy of the State of Idaho. We have held one last Friday in Coeur d'Alene. It was very successful.

Good morning, Larry.

Representative Craig. Good morning.

Senator Symms. We had some excellent witnesses. I think some of the Idaho citizens that testified made some very good contributions to the hearing record. These hearings are being held by the Joint Economic Committee, but they are also in conjunction with the Senate Finance Committee, which I'm on, and the hearing record is going to be made available to the Senate Finance Committee.

Senator Packwood is very interested in the outcome of these hearings also because they have a similar parallel in parts of the economy in Oregon, in part of the agricultural economy, and certainly the forest products, timber industry economy and some of the impacts of different tax proposals on the economy in Oregon. So he's interested in what the witnesses have to say here in Idaho.

I think that most of us agree with some of the things that President Reagan has said about our current tax law, that it's too complicated. It's viewed that it isn't as fair as it could be by many thousands of taxpayers, millions of taxpayers. And I personally laud the President's effort to try to make the Tax Code more fair and more simple.

However, in examining the tax bill when we first started looking at it, my concern was that it does not remove the bias that is in our current Tax Code against savings, which is, as you all know, that a person in our present tax law and even in the proposals that are before the Congress, they can make deductions for their interest on money—when they borrow money, they can deduct off the interest, but when they save money, they get taxed on their interest income. So that puts a bias in the Tax Code that has created the necessity for some of these other mitigating tax deductions, such as accelerated depreciation, mineral depletion allowances, special tax treatment on timber products, and some of those.

Those are ways to mitigate the long-term and heavy capital-intensive expenditures that are required in the production of natural resources. And those are the areas where I want to focus on, and I think those are the areas that are critical to the employment in Idaho.

There isn't a single person in the State of Idaho that is not going to be impacted one way or another if the Congress chooses to pass some kind of tax reform in this year or next year or whenever this may happen.

I personally am very skeptical that any tax reform will be passed this year, although it's still scheduled to be done. It is an enormous task. The administration and the tax writing committees are worshiping at the altar of the shrine of revenue neutrality, and what that means in our language is that they want to not have it be either a tax increase or a tax reduction in total dollars in the macro sense.

Therefore, any of these things that we think are to save jobs in Idaho, like mineral depletion allowances or growing costs on trees, for example, that have a direct impact on the viability of these industries that hire thousands of people in Idaho and provide their livelihood, they say to us, "We'll figure out a way to pay for that."

And so I think those are the things that we need to think about in the context of this hearing, and I will look forward to what the witnesses have to say this morning.

You all have the witness list. And I would just like to say first that on the left side of the column on the witness list where it has the time on there, the Chair would expect that we would beat that time schedule by quite a little bit. So I would think that—it would be my target to have this hearing completed by 1 p.m. So any of you that are on the list, I hope you don't wait until 2:30 on panel 7 to be here to testify, because I'd hope to have the hearing completed before then. I'm sorry that that got out. I'd just like to ask everybody to disregard that time.

We'll try to keep your original statements to between 5 and 7 minutes wherever possible, and we'll have a little time for some questions.

I want to say that there are a lot of things about what the President is calling for that I think are good. I think it's a good idea to reduce tax rates. That is the best way to gradually work your way out of the so-called tax shelters that do concern thousands of taxpayers. If the rates are lower, there's less incentive for taxpayers to look for ways to defer or reduce their tax liabilities and be willing just to pay the tax rates.

I think we could probably do much better than the administration's bill, and that's why we want your testimony because I think there are areas in the bill that can be changed to make it a much better, more pro growth, pro jobs, pro capital investment risk-taking type of a taxing system.

I want to make some introductions up here. Of course, you all know Congressman Craig.

And I might just say, first to the left over here, is Glen Youngblood, who is in charge of the legislative part of my office with respect to natural resources. Glen is a long-time Boise resident. Many of you may know Glen.

Next to him is Dwight Ripley, who is a CPA who has just left his CPA practice here in Boise to join my staff to give us the kind of help we need in a measure that's as important as this to everybody in Idaho.

Rip lives in Nampa. He has now joined my staff in Washington. He will be living in the Washington area in the next month. He's going to be moved back there by September when we go back in session with the sole purpose to concentrate on this part of my responsibility, to give me the help. He's been a practicing accountant in a local CPA firm here in the valley.

Behind him is Joe Cobb, who is an economist from the Joint Economic Committee.

Joe, before we go any further and before we ask Congressman Craig if he wants to say anything, if you could just take a couple of minutes to just go down and show what all of those charts are.

And the reason I put those up—there's two charts I wish we had which would talk about how much the national debt is and how much the rate of growth and where it's heading and how much the interest is on the national debt and what it costs the taxpayers of this country, because I've been one of those that said—the fact is, I had a meeting last night with my own personal CPA, and his comment was to me that he didn't think the Congress ought to be allowed to do one thing until they stopped Federal spending. They shouldn't be allowed to tamper with the Tax Code, or anything else, until they get Federal spending back in line with revenues, but I think to have a hearing like this, it's good to put everything in context where we are.

So, Joe, if you'll take your pointer and go down through there and point that out to everybody.

And then we'll hear from Congressman Craig, and then we'll start with our witness list.

Mr. Cobb. As you may have heard, Government spending has increased rather dramatically in the last 10 years. In 1976, the total Federal spending was around $400 billion. And now Federal spending 10 years later has gone up above $900 billion.

This dramatic increase in Federal spending has been driven primarily by a much more rapid increase in the so-called uncontrollable spending. These are the spending for entitlement programs, programs where the Congress simply says: "A citizen is entitled to come to the Federal Treasury and take whatever formula amount that Congress has set based upon certain criteria the person may meet, whether they're disabled, whether they are a retired person with Social Security, whether they have price supports in various programs."

You'll notice the rate of increase in these entitlement programs, which Congress does not even attempt to limit except by defining how much you're entitled to, it is growing much more rapidly than general spending.

As an example of the changes that were made in the Reagan administration, this chart shows the rate of increase from 1974 up through the point where President Reagan took over from President Carter.

The Carter budget, as you see, would have continued this line—this trend line up at this angle, but the Reagan program has not reduced spending but has reduced the rate of increase in spending.

This chart here demonstrates the relationship in the Federal budget between receipts and outlays.

You're all well aware of the famous tax cut of 1981 which, in fact, only stopped the revenues of the Federal Government from increasing as a share of gross national product. The revenues had always been between 19 and 20 percent down as low as 18 percent in 1972, but by 1982, Federal revenues were taking about 22 percent of gross national product.

Spending, on the other hand, which had been in the mid-1960's, also around 19 percent of gross national product, has now risen above 25 percent of gross national product.

You'll see the effect this has had on the profitability of businesses in this country. The long-term slide in business profitability; the high point was in about 1964, and for the 10 years, 20 years since then, it has slid progressively down to the point where business profitability today is in the 6, 7, or 8-percent range. And that's even after all of the tax cuts that business received with the 1981 tax bill.

The last three charts, which are much more technical—and I won't describe them in as much detail, because you can examine them later—show the comparison of the three major proposals before Congress today compared with the present system.

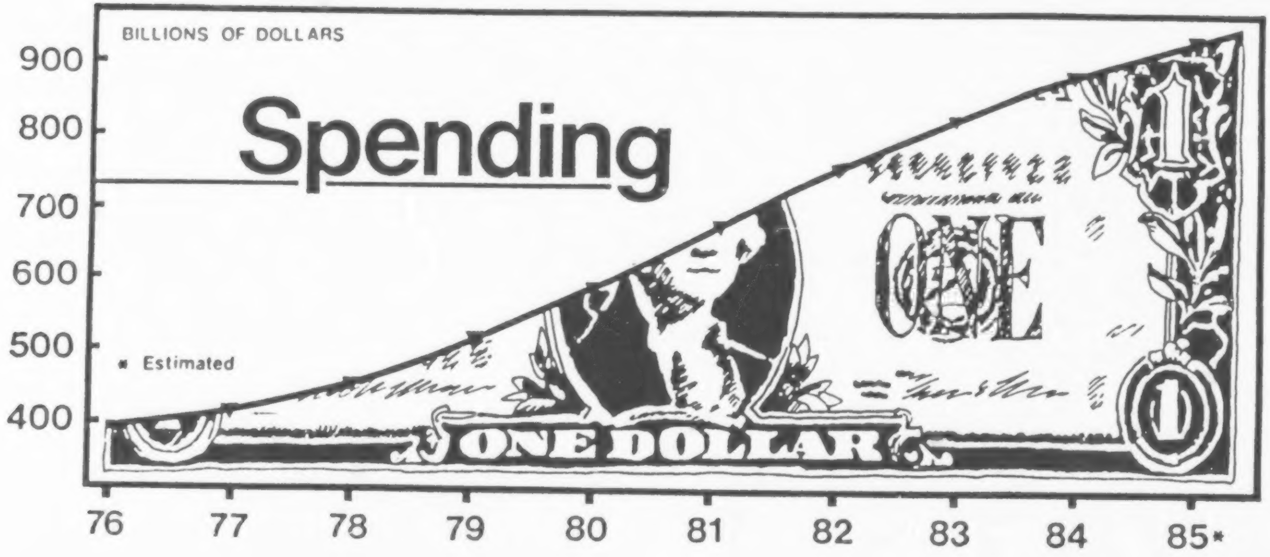
This chart, third from the end, has small business tax rates and the maximum corporate tax rates under the Reagan plan, the Kemp-Kasten plan, which is supported by most of the Republican Members of Congress, and the Bradley-Gephardt plan that's supported by most of the Democratic Members of Congress.

The next to the last chart shows the same three plans compared to the present system as it would affect individuals. It shows the brackets that they are proposing, the minimum per capita, individual deductions that they are proposing, and how they would compare with the present system.

And the final chart—which is too complicated to even explain; you'll have to just study it—shows how the President's tax plan, when you distribute it across the different classes of income groups, how many people in that group would get a tax cut, how many people in that group would get a tax increase, and how many that are in that group would have no change.

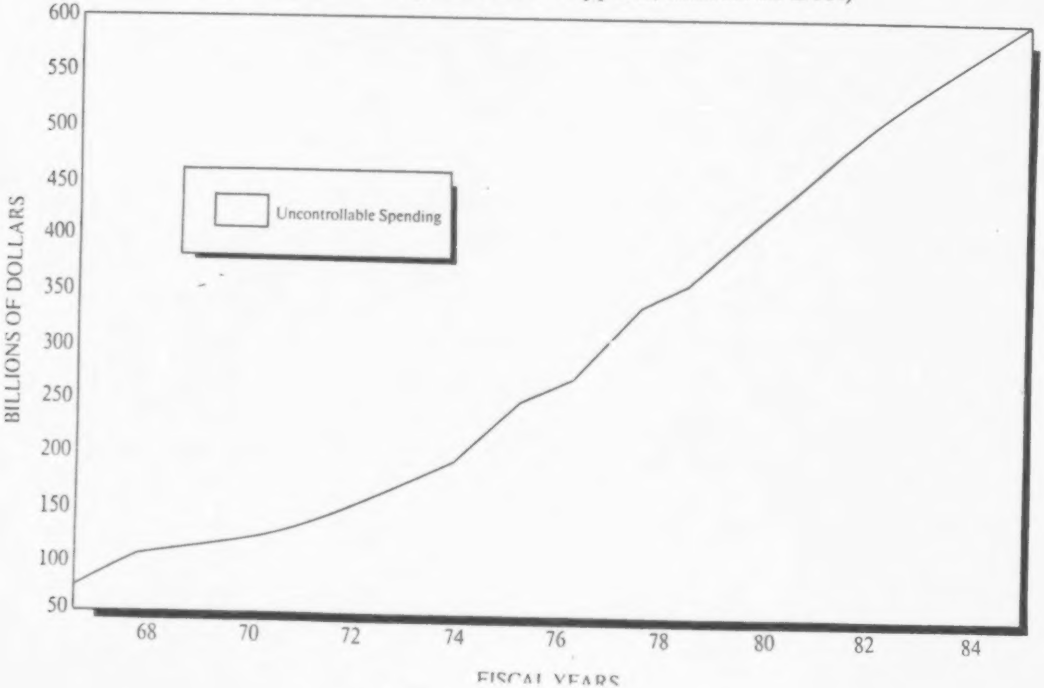
We also had a handout which most of you have picked up that goes into many more of the very specific details of how the three plans affect business taxes and individual taxes.

[The charts referred to follow:]

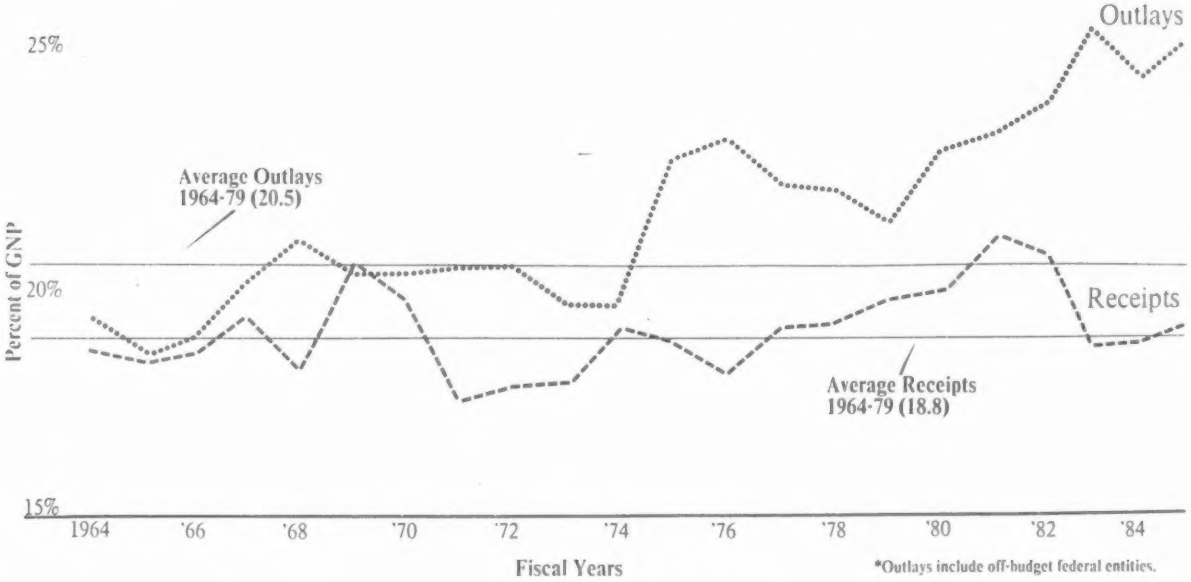

BILLIONS OF DOLLARS
Spending
900
800
700
600
500
400
* Estimated
ONE
ONE DOLLAR
1
76
77
78
79
80
81
82
83
84
85*

"Uncontrollable" Spending from 1967 to 1985

(Entitlement Programs, Price Supports, Interest on Debt)

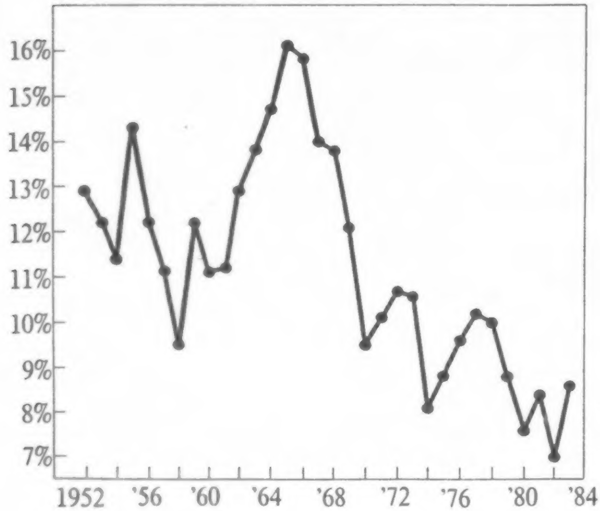


Outlays and Receipts
Percentage of GNP, 1964-1990



*Outlays include off-budget federal entities.

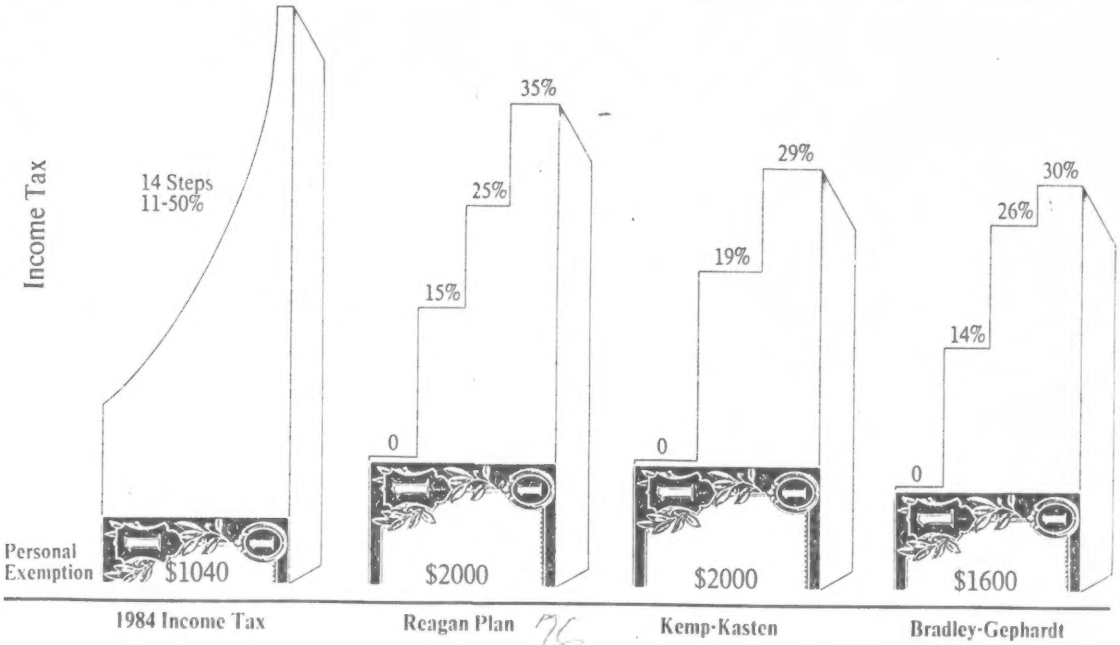
Long-Term Slide In Business Profitability*



*Nonfinancial corporations. Pretax profits (with inventory valuation and capital consumption adjustments) plus net interest as a share of the net stock of reproducible fixed capital at replacement cost.

Chart /Senate Republican Conference

Tax Reform Proposals
Married Couple With Two Children



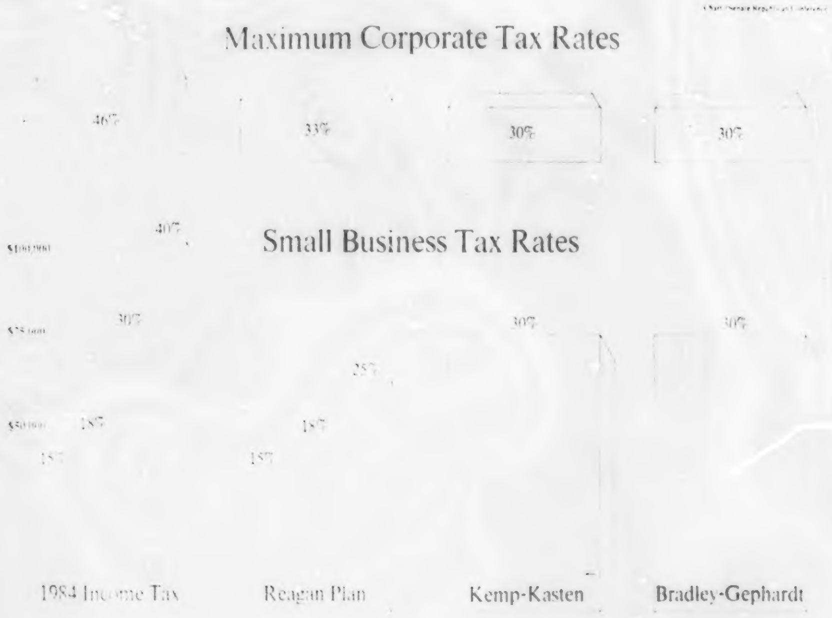


Chart: Senate Republican Conference

Maximum Corporate Tax Rates

Small Business Tax Rates

Tax Change Percentage by Family Economic Income

(Under the President's proposal)

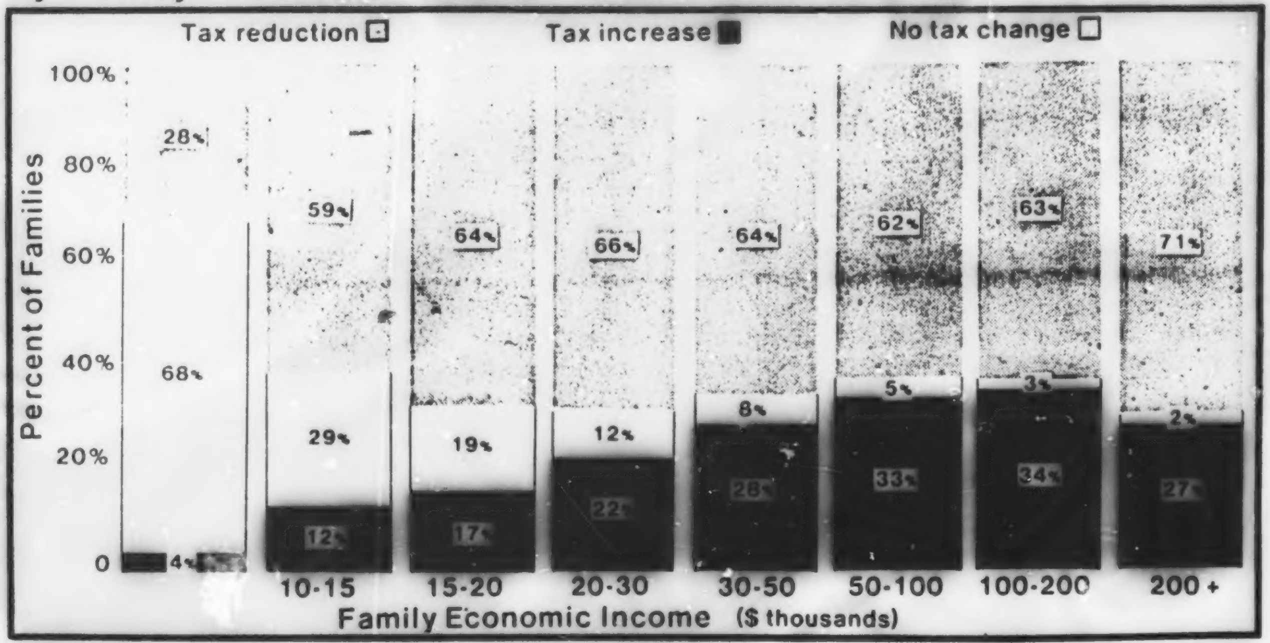


Chart /Senate Republican Conference

Senator **Symms**. Thank you very much, Joe. I appreciate that explanation. I think that does put things somewhat in context.

To overgeneralize it, what the President's tax proposals have done is, they have raised taxes to the business sector so they could reduce taxes on individuals. And that is what I was mentioning about revenue neutrality. So some of us are questioning whether it's really more fair and more simple. It's just a change of the current tax system.

Now, Congressman Craig, did you have any comments you wanted to make at the outset before we start our witnesses?

OPENING STATEMENT OF REPRESENTATIVE CRAIG

Representative **Craig**. Very briefly, because I want to make sure you all keep on schedule.

Let me thank you for being allowed to participate this morning and sit in on this hearing. I applaud you on holding a series of hearings of this nature across the State.

I know there is a great deal of frustration at this moment about what the President's tax plan means and what its impact will be on individuals and business and industry, not only in this State but across the Nation. I don't think there is any doubt that we all applaud the idea of simplifying tax and also making it as fair as it possibly can be.

At the same time, I have growing fear that as we fumble with the budget in Washington, there is a growing interest, both in the House and in the Senate, that maybe this tax package ought not be revenue neutral. And I think your CPA spoke clearly to you last night, as both Steve and I and Senator McClure know, the problem as these charts demonstrate.

It isn't a question of more revenue for the Government; it is a question of spending. And it will be a great concern to all of us as we attempt to craft the tax package and keep it revenue neutral.

Dan Rostenkowski, chairman of House Ways and Means, said, just before the recess, that he would start markup on a tax bill in the House in late September when we come back from this August recess. So it will be important if we get all the input we can.

I'm going to be following these hearings, reading the testimony, and taking as much of it as I can. And I think it's clearly relevant to Idaho as a resource State and to the House Ways and Means Committee to submit into their record so that we can have the input that you're giving to Steve over on the House side also, because I think it will be very valuable.

And when I look at the panel this morning and the cross-section of people that are here to testify as it relates to Idaho's economy, it makes me all the more interested in what you have to say so that I can reflect that through to the House Ways and Means Committee because, of course, it will be keyed along with the Senate in crafting a tax proposal that it appears is going to at least start the process by late September or early October this year.

Steve, let me thank you very much for allowing me to be a part of this hearing.

Senator **Symms**. Thank you. We're delighted to have you here.

I want to make one last introduction. Senator McClure has followed this entire hearing process very carefully with his able staff assistant, Jack Gerrard, who is here. Jack has been very attentive, I've noticed, at the Senate Finance Committee hearings. We've had a lot of series of hearings in the Senate Finance Committee this year with different groups testifying.

And as I said, I thought we had excellent testimony from Idaho citizens in Coeur d'Alene.

We are going to have this hearing today, and then the one in Idaho Falls tomorrow. And I think we'll have a pretty good picture of how it will affect the employability and employment viability in jobs in Idaho, because I think that is the No. 1 priority, as far as I'm concerned, that nothing is done to the Tax Code that would jeopardize the ability of Idaho families to be able to earn their living in this State in the future.

So if we could call up the first panel: Mr. Ken Schmick, Sunshine Mining Co., Lowell Shonk, Cyprus Mines; Buzz Gerick and Milt Jones of NERCO, Inc., and that's the DeLamar Mine.

[Whereupon, the panel members assembled.]

Senator SYMMS. Gentlemen, do you have written testimony? If you do, maybe Joe could get a copy of everybody's testimony so I'd have a stack of them here, and then I can follow along with what you're saying.

OK. Ken, why don't you go right ahead.

STATEMENT OF KEN R. SCHMICK, ASSISTANT VICE PRESIDENT, SUNSHINE MINING CO.

Mr. SCHMICK. Thank you. Senator Symms, Representative Craig, and members of the committee, I am appearing before you today at the request of Jack G. Peterson, executive director of the Idaho Mining Association. We at Sunshine appreciate this opportunity to testify with respect to the President's tax proposals.

Sunshine Mining Co. is a natural resource company engaged primarily in the exploration for and extraction and sale of precious metals and oil and gas.

I will limit my remarks to how these tax law changes affect our mining segment.

Sunshine currently operates three precious metals mines and employs approximately 750 people in our mining division. Approximately 600 of these people reside in Idaho and are principally engaged in the operation of the Sunshine Mine located near Kellogg, ID.

In 1984, Sunshine's mining operations produced 5,900,000 troy ounces of silver, 12,300 troy ounces of gold, 2,100,000 pounds of copper, 1,300,000 pounds of antimony.

Sunshine's ability to continue producing these materials is largely dependent on four factors:

The first factor is the market price of our products. Essentially we cannot control these prices as they are freely traded commodities on the world market.

The second factor is the cost of production. Most of our labor costs are fixed by negotiated employee agreements. Our material costs have continued to rise with or exceed inflation. Taxes, from local property taxes to State and Federal income and severance tax must be included.

The third factor is the success of our exploration efforts. As we are in the business of extracting a nonrenewable resource, we must constantly be looking for more mineral reserves. With the exception of some technological improvements in mining and metallurgy, these reserves are increasingly more difficult to locate and more costly to extract.

The fourth factor is the cost of capital. All of our efforts require money. If our cost of money is greater than other world commodity producers, we are going to have difficulty justifying the extraction and sale of these commodities on the world market.

Concerning the percentage depletion allowance, in the last 5 years, even with curtailments of production due to strikes and low market prices, Sunshine has realized approximately $3,100,000 in tax savings from utilizing the depletion benefits.

In this timeframe, we have opened up two new operations, both of which were justified in part from utilizing the depletion allowance. Without these allowances, I am not certain we would have risked the $35 million that we did. In fact, if we would have known current silver prices, I am sure we would not be operating these properties today.

It is these market risks and intense capital requirements that require a depletion allowance to provide the incentive necessary to maintain a domestic mining industry.

I'd like to talk about the exploration and development expenses. Because we are in the business of using nonrenewable resources, there is very little difference between production costs and exploration and development costs. Every time we produce a ton of material, we must spend the money to replace those reserves.

In recent years—to categorize these expenditures differently is hard to understand and self-defeating.

In recent years we have been compelled to capitalize a portion of these expenditures. Now it is suggested that a portion of these expenditures be classified as preference items subject to a minimum tax. These changes will have the effect of discouraging new mine exploration and probably encouraging raiding other companies for their proven reserves.

If this situation is allowed to continue, the availability of proven domestic reserves will decline. The risks involved in the extraction of natural resources is simply too great for our present depressed mining industry to go it alone.

In the President's proposal, it is pointed out that preferences granted to specific industries should be curtailed except where there is a clear national security interest. Natural resource industries such a mining, timber, and oil and gas were given as examples where preferences have been given for which no national security interest exists.

It should be pointed out that these are industries that cannot be turned on rapidly during a time of need. Our national security is dependent upon a strong diversified economy and the more this country relies on imports to feed our basic industries, the more risk we must assume in maintaining that economy.

CAPITAL COST RECOVERY SYSTEM

While this modification does not seriously impact my company at this time, i am concerned about the direction the CCRS is taking. We are in the process of modernizing our operations and any delay in recovering the tax benefits will affect our capital decisions.

In 1984 and this year, Sunshine spent approximately $12 million toward a total cost of $18 million constructing a new smelting and refining process to treat our Sunshine Mine concentrate. These are the types of expenditures that must be encouraged in our industry. Any impediments placed on these projects such as elimination of investment tax credits or longer recovery periods will seriously impact our ability to compete in the world market.

I am strongly in favor of closing the loopholes that ACRS created, but the thing I liked about ACRS is its simplicity. CCRS is certainly going to complicate our business. Trying to forecast market prices has always been difficult enough, but now we would have to forecast inflation as well in order to justify capital expenditures, and I am not sure the added pain is worth the benefit.

In summary, this tax proposal places too much of a burden on the natural resource industry. It is extremely difficult to get bankers to talk to us today because of our low commodity prices. If these changes are allowed to become law, I can't see banks or stockholders being willing to take the risks necessary to perpetuate a domestic mining industry.

I thank you.

Senator Symms. Thank you very much for a very excellent statement, Ken. I hope you can just stay right there. We're going to have some questions. But I'd like to go down through the panel first.

Go ahead. Lowell Shonk from Cyprus Mines.

STATEMENT OF LOWELL SHONK, ADMINISTRATIVE MANAGER, CYPRUS MINERALS CO.'S THOMPSON CREEK MINING CO.

Mr. Shonk. Good morning, Senator Symms, Congressman Craig, ladies and gentlemen.

My name is Lowell Shonk. I'm the administrative manager at Cyprus Minerals Co.'s Thompson Creek Mining Co. Cyprus Thompson Creek operates a very large open pit molybdenum mine 30 miles southwest of Challis. The mine and processing facilities currently employ about 390 people.

Cyprus Minerals Co., prior to July 1, 1985, was known as Amoco Minerals Co., a subsidiary of Amoco Corp. Amoco is the new name for Standard Oil of Indiana.

On July 1, 1985, Cyprus Minerals Co. was spun off from Amoco Corp. and is now an independent publicly owned company headquartered in Englewood, CO.

Over the months, you and your staff and your fellow Members of Congress have heard testimony on certain provisions in the proposed tax plans that could adversely impact the mining industry. Cyprus, too, is concerned about the provisions that phaseout the percentage depletion allowance and the effect such a move could have on our ability to generate the needed capital to provide financing through the long lead time from exploration to commercial production.

Our Cyprus Thompson Creek molybdenum project spanned 15 years from exploration activities in 1968 until the startup of molybdenum production in late 1983.

Because of the recent spinoff, many departments, including those handling financial data in Cyprus Minerals Co., are in a state of flux. Corporate headquarters personnel are establishing systems and methods for many activities that up until six weeks ago were performed by the large staff groups at Amoco Corp. in Chicago.

Cyprus realizes that you need specific data to be able to establish and effectively support your position on the tax provisions, and since Cyprus management also needs such data to plan future operational strategies, Cyprus is studying the tax proposals' effects on our company.

With management's approval, we'll share such data with you as it becomes available.

However, one of the administration's tax proposals, the recapture of depreciation, is of such immediate concern to Cyprus that we promptly analyzed the provision's direct impact on us.

The proposal requires taxpayers to recapture 40 percent of excess depreciation taken between January 1, 1980, and July 1, 1986. Excess depreciation is essentially the difference between accelerated depreciation of property over straight line depreciation. Because the administration proposes a reduction in the maximum corporate tax from 46 percent to 33 percent beginning July 1986, we understand that the tax on the recaptured amount is intended to offset the supposed windfall tax benefit from depreciation deductions taken during the period 1980 to July 1, 1986.

For Cyprus Minerals Co., this provision would result in about $40 million of tax.

As mentioned earlier, until June 30, 1985, Cyprus was a member of Amoco's affiliated group of companies and, although Cyprus suffered tax losses in those years exclusive of depreciation deductions, the group was able—that is, the Standard Oil or Amoco group—to use depreciation against income from nonmining activities. Thus, although Cyprus Minerals received no direct tax benefit from its depreciation deductions, it apparently will have to pay recapture tax for those deductions which were used by the Amoco group.

This burden would greatly impair Cyprus' ability to survive as an independent company in the mining industry.

A letter is being prepared, as you have requested, detailing the consequences of the recapture tax provision's unique and heavy impact upon Cyprus. The status of individual facilities, including Cyprus Thompson Creek, are dependent upon the overall performance and successes at Cyprus Minerals Co. The company is doing its part to be competitive in today's weak minerals markets. Every effort is being put into being able to show a positive figure on the net income line.

Cyprus has installed state-of-the-art equipment at facilities in order to achieve efficient, low-cost per unit production. Newly acquired properties include modern equipment enhancing their low-cost production capabilities.

Systems and methods throughout the company are constantly being evaluated for positive cost-benefit ratios. Contracts with vendors and suppliers have been rewritten to lower costs.

With all of our efforts, it is very discouraging to be faced with disincentives in the current tax proposals. We hope that the lines of communication that you have initiated with this and your other meetings in Idaho will be utilized by us, your constituents, and in return by you and your staff.

In that vein, if you have any questions, I will be happy to answer those I can, and any questions for which I don't have an answer, either I or another Cyprus Minerals staff person will get back to you with the answer. Thank you for your time and attention.

Senator SYMMS. Thank you very much for another excellent statement.

Buzz Gerick, you can go ahead.

Did you and Milt both want to testify?

Mr. GERICK. Yes.

Senator SYMMS. Go ahead and testify.

Mr. GERICK. Yes; I'll start it out.

STATEMENT OF EDWARD "BUZZ" GERICK, GENERAL MANAGER, DELAMAR MINE, NERCO MINERALS CO.

Mr. GERICK. Mr. Chairman and members of the committee, I want to thank you for the opportunity to present testimony today.

Senator SYMMS. Do you have a prepared statement?

Mr. GERICK. Yes; I believe it has already been submitted.

Senator SYMMS. See if you can find those. If there are any extras of the witnesses, bring three or four of them up here so we can kind of follow along.

Go ahead, Buzz. I'm sorry.

Mr. GERICK. No problem.

For the record, I'm Buzz Gerick, general manager of the DeLamar Mine, located in Owyhee County, ID, about 100 miles southwest of Boise.

I'm representing NERCO Minerals Co., a top 10 domestic producer of gold and silver.

NERCO Minerals Co. is a subsidiary of NERCO, Inc., a diversified mining and resource development company, and a top 10 domestic producer of coal.

Seated to the right of me is Milt Jones, director of Federal and regulatory affairs to NERCO, Inc., and will give testimony following my introduction.

Written transcripts of our testimony have been provided.

The DeLamar Mine is operated and 100 percent owned by NERCO Minerals Co. Since opening in 1977, the mine has produced more than 12 million ounces of silver and 160,000 ounces of gold.

We presently have and will continue to have 175 employees and an annual payroll of about $5 million.

The mine has contributed more than $2 million in tax revenues to Owyhee County alone, and in excess of $750,000 in State mine license tax since opening in 1977.

NERCO Minerals Co. began operating the DeLamar Mine in 1984. Since then, we have made substantial progress at reducing direct operating costs and greatly improving productivity. We've been able to make these improvements through cash contributions from our parent company.

For example, this year alone we added a new fleet of mining equipment valued in excess of $4.5 million. This equipment will result in significant improvements in our operating efficiencies.

In addition to that, we have made an aggressive exploration program designed to increase our ore reserve base. This year alone, that exceeds $500,000.

At current production, the life-of-mine at DeLamar is projected to be 12 to 13 years. Successful exploration results could potentially extend that mine's life.

Let me talk for a moment about the state of the mining industry.

As you all know, the mining industry is severely depressed at this time. As an industry, we have not benefited from the economic recovery of the past 2 years. Metals prices are at cyclical lows and foreign competition is fierce due, I think, to a large part to low labor rates and government subsidized funding, which we do not have here.

At this point in the market cycle, the mining industry cannot afford the shock from tax reform.

The administration's tax proposal—let me talk about that for a second. NERCO does recognize that there are desirable aspects of the President's proposal to simplify the Tax Code and to neutralize the effect of tax policy on private investment decisions.

However, in its present form, the tax reform package could starve our industry of the cash-flow it needs to make productivity improvements, like we've recently made at DeLamar, and other investments to meet the challenge of foreign competition and depressed market prices.

And our industry has made significant financial commitments which were based upon current development policy and tax treatment.

The bottom line is that the U.S. Government should be working toward strengthening, not weakening, our domestic natural resource foundation.

Unfortunately, the current proposal could dramatically undermine the U.S. mining industry which is already very depressed.

At this time, I'd like to turn our testimony over to Milt Jones to discuss some aspects of the tax reform package which we—which are of particular concern to NERCO and the mining industry.

Thank you.

Senator SYMMS. Thank you very much, Buzz. Your entire statement—and all of your entire statements will be part of the record. That was an excellent statement.

Milt.

Mr. JONES. Thank you, Senator.

By the way, I had some of your Ste. Chappelle wine last night for the first time.

Senator SYMMS. Say that louder so everybody can hear. [Laughter.]

Mr. JONES. I had Ste. Chappelle wine last night. I was very impressed.

STATEMENT OF MILTON JONES, DIRECTOR, FEDERAL AND REGULATORY AFFAIRS, NERCO, INC.

Mr. JONES. As Buzz and the others here have indicated, we, too, have taken a close look at the administration's proposal and, taken as a whole, we fear that it will undermine basic capital-intensive industry in this country in its current form.

It is particularly severe to the mining industry because in addition to removing capital incentives such as ACRS, investment tax credits applied to all capital-intensive industries, removes a couple of items which are of particular interest in the mining industry in addition.

Price Waterhouse and Arthur D. Little have just completed preliminary studies which indicate that the impact to the coal industry would be to increase the taxes by some 58 to 62 percent. You don't have much coal in Idaho, but it's the revenues from the coal industry at NERCO which go to finance improvements in our other operations such as the ones at DeLamar Mine.

This is a bad time to hit the mining industry. In addition, as Buzz has indicated and as you all know, the economic condition of the mining industry right now is simply not good.

We all need cash to meet foreign competition, to improve our productivity. And in the absence of being able to do that, my fear, with Business Week's, the indication that the mining industry is dying may well prove to be true in the United States. The situation is very serious.

Specific to mining, I wanted to cover two items in particular, one of which has already been mentioned by the others in this panel.

The first is percentage depletion.

The loss of percentage depletion is probably the single-most serious blow which would be dealt to the mining industry by the administration's tax proposal. I think it needs to be borne in mind that while they're a desirable aspect of the administration's proposal to eliminate some of the questionable tax shelters and loopholes from the code, percentage depletion doesn't really fall into that category. Percentage depletion is not new to the code. It has been in the code since at least 1954. And if I remember correctly, it was a part of the code even before the 1954 revision. It is also not used for questionable tax shelter purposes. It's simply an integral part of mine economics. It is used by the industry that way.

I personally cannot think of a way to use percentage depletion as a real tax shelter or loophole vehicle in the sense of using it for abuse.

Senator SYMMS. How much is percentage depletion?

Mr. JONES. Percentage depletion for gold and silver operations is 15 percent, and for coal, 10, currently.

Senator SYMMS. So if you put that in terms of cost of production, like on coal, how much a ton does it amount to?

Mr. JONES. It's a percentage of the sales price.

Senator SYMMS. So it's 10 percent of whatever you're selling coal for?

Mr. JONES. Correct.

Senator SYMMS. And in the same way that silver's 15 percent——

Mr. JONES. Fifteen percent.

Senator SYMMS. So you're talking about today, at today's low prices, it's still—let's see, 60, 70 cents an ounce, that a new cost would be added on top of your already cost?

Mr. JONES. That's correct.

Senator SYMMS. I didn't want to stop you before you completed, but——

Mr. JONES. No; please do.

Senator SYMMS. I do have a question I wanted to ask you. Have you completed?

Mr. JONES. No; I would like to continue a little bit.

Senator SYMMS. Go ahead and finish. I'm sorry. I didn't mean to stop you.

Mr. JONES. No; that's fine.

We think that percentage depletion is a sound incentive for mineral development, largely because it allows tax-free recovery of reserve value. The percentages are calculated so that—or put in the code so that what we're designed to do is recapture the reserve value rather than to cost depletion. The reason it is in the code in that fashion is so that operators recover the amount necessary to get new reserves. New reserves are always going to be expensive and more risky than the reserves you are currently mining.

And percentage depletion is designed to recapture an amount necessary to retain those reserves rather than, for example, as you would normally think of depreciation, recovering costs of the item which you are using up.

As you know, mining is one of those industries where you are constantly depleting what you have; you are constantly depleting your assets. The only way to stay in business is to get new assets to deplete.

As Buzz mentioned, the economics of current operations rely on percentage depletion. And we feel in particular that if you do end up removing percentage depletion, that at a very minimum it's very necessary to grandfather or have a transition rule which allows percentage depletion to continue to apply to operations where substantial investments have already been made, reliance on it.

It would be a very, very serious blow to any operation representative in this room today to have a percentage depletion taken out after having made an investment necessary to cover those reserves in reliance, under economics which rely on that.

The other aspect of the proposal that I wanted to deal with today was one that you dealt with in 1984, and perhaps you will recall, the changes in reclamation accrual treatment.

Under the current—under previous law, you are allowed to take deductions for reclamation ore as you mined the product in, as you claimed it.

In 1984, working all parties, primarily in the Senate Finance Committee and together with the Treasury Department, that capability was eliminated except for those situations where there was a preexisting long-term contract which relied on the economics of being able to take a reclamation deduction during the course of mining.

The administration proposal would remove that transition rule treatment. And again, we're faced with a situation where not only have we invested in operations relying on that tax treatment, but we are wrapped into long-term mineral sales contracts, the economics of which are dependent upon being able to take that reclamation deduction.

In both cases, then, we feel it's desirable to retain percentage depletion and reclamation accrual deduction capability as it exists in the current law. But at a minimum, I'd strongly urge you to consider transition rule treatment to current operations.

That would conclude my statement.

Senator SYMMS. Thank you very much.

[The following information was attached to Mr. Jones' statement:]

NERCO POSITION ON THE PRESIDENT'S TAX REFORM PROPOSAL

NERCO recognizes there are desirable aspects of the President's May 28, 1985, proposal to simplify the federal tax code and to neutralize the effect of tax policy on private investment decisions. However, we believe that tax reform should not be hurriedly pursued without regard for the fact that current tax provisions were designed to channel private enterprise efforts toward the accomplishment of important national goals. These goals include development of U.S. energy resources to ensure energy independence and to maintain a solid domestic natural resource base for American industry and our national security. The President's proposal should be recognized for what it is - an industrial policy which will undermine basic natural resource industries in the United States and shift investment toward less capital-intensive segments of the economy. Moreover, because mining requires long-term commitment of capital, revoking current tax provisions reneges on the economics of existing operations.

As one of the 10 leading domestic natural resource development companies in three commodities (coal, silver and gold), NERCO is acutely aware of the adverse economic circumstances which continue to face the mining industry. The domestic mining industry is not healthy anbd has not benefitted from recent improvements in the economy. It doesn't need the shock of tax "reform". The reductions in cash flow produced by the President's proposal are particularly damaging because they reduce the funds needed for investments in productivity improvements which are essential if the mining industry is to remain competitive in the face of foreign compeition.

Significant financial commitments have been made, including long-term financing and product sales agreements, which rely upon current development policy and tax treatment. Even if Congress determines that our policy of encouraging a strong natural resource industry must be abandoned in the interests of tax neutrality, such a dramatic change should take equity into account and be phased in so personal and corporate dislocations resulting from this change can be alleviated.

The coal industry represents a striking example of this policy problem. In the 1970s Congress called on United States coal producers to lead the country to energy independence in the wake of the mideast oil embargo. The importance of utilizing domestic coal reserves was further underscored by the 1982 report to the Joint Economic Committee of the United States Congress which urged that the public and private sectors both take steps to ensure that coal production expansion proceed in an orderly and expeditious manner. The coal industry responded and provided for a 41% increase in coal consumption. The President's tax proposal, however, would remove not only the incentives for expanding coal production but would also remove provisions forming the economic basis for current operations. It would do this at a time when the United States coal industry is facing severe competition from foreign coal producers (assisted by their governments) in both domestic and world markets. On another front, we also now face competition from imported Canadian electric power which would supplant domestic coal-fired generation. Adding insult to injury, the President's proposal would continue incentives for production and use of our limited petroleum resources.

The mining industry today also faces a disproportionate level of costly federal impositions outside the income tax area. The coal industry in particular has been hard hit by stringent Clean Air Act requirements affecting both mining operations and coal-fired facilities; very expensive regulatory requirements are imposed before, during and after mining by the Surface Mining Control and Reclamation Act; surface coal is taxed for a black lung problem it had no hand in creating (NERCO paid more than $7,000,000 to support the federal program last year), and railroad rates for coal shippers have been deregulated allowing the railroads pricing freedom even in monopoly situations.

Adding to this substantial cost burden, NERCO estimates that the President's proposal could increase its taxes by one-fourth over the next four years. That makes a mockery of the supposed "neutrality" of the proposal.

Two aspects of the tax proposal are of particular concern to us. The first is the elimination of the percentage depletion allowance. The second is elimination of accrual deductions for mine reclamation and closeup costs.

Percentage Depletion

Percentage depletion is deduction of a percentage of gross income from mineral development property. It is used as a replacement for cost depletion, which is a deduction for the portion of the total cost basis of a mineral reserve sold in a given year. Percentage depletion is the most important tax provision encouraging orderly development of United States mineral resources and an economically sound domestic mining industry. It helps ensure adequate cash flow to address the above average risks and capital requirements of development and production activities.

Unlike oil and gas operations where the greatest expense is incurred during exploration, the greatest mining expenses are incurred during development and production. This corresponds to the production related nature of the depletion allowance. The recovery of reserve value rather than cost reflects the greater expense of developing new reserves which replace those being depleted in the course of mining operations.

Percentage depletion is neither new to the tax code nor among the incentives used for questionable tax shelter purposes. It has been a part of the tax code for more than thirty years and is an integral part of mine development economics for mineral operations. At a minimum, percentage depletion ought to remain a part of the federal tax program for current operations.

Reclamation Expenses

Under current law, companies may deduct the cost of reclamation and mine closure associated with current mining activities, even though the actual reclamation work will be performed in the future. These deductions are accounted for in a sinking fund maintained for tax purposes. Interest is deemed to be earned on the fund, which reduces the total amount of reclamation cost deducted over the life of the property. In effect, reclamation expenses are discounted.

The sinking fund provisions were added in 1984 after a number of long-term mineral supply agreements had been negotiated which relied upon undiscounted accrual deductions. For this reason, an exception to the sinking fund provisions was added which grandfathered the treatment of coal sold under pre-existing contracts as long as the contract continued in force.

Congress carefully deliberated on the tax treatment of reclamation expenses prior to passing the 1984 Deficit Reduction Act. In particular, the 1984 transition rule for previously existing mineral supply agreements should be retained even if other reclamation and mine closeup provisions are eliminated in favor of a cost accounting approach.

KEY POINTS CONCERNING

TAX REFORM AND THE MINING INDUSTRY

General

- The Administration tax proposal taken as a whole will undermine basic industries and shift investment toward less capital intensive enterprises. In this regard it is an industrial policy. This will increase U.S. dependency on other nations for natural resources and energy supplies.

- The United States mining and energy industries are facing increased foreign competition in both world and domestic markets. Many foreign competitors are actively assisted by their governments in their efforts.

- Costs imposed by the federal government other than taxes have already driven up the cost of coal disproportionately (e.g., Clean Air Act, Surface Mining Control and Reclamation Act, and Clean Water Act).

- The Administration's proposal would sharply reduce the cashflow of many natural resource companies. Cashflow is critical to our ability to invest and obtain productivity improvements necessary to meet foreign competition. Preliminary studies by Arthur D. Little and Price Waterhouse indicate that the Administration proposal would increase the taxes of the coal industry by 58-62%.

- Leaving oil development incentives in place while at the same time eliminating provisions which promote the development and use of coal resources sends the message that coal no longer counts in our energy picture.

- The economics of existing operations and mineral sales contracts rely on current tax policies. At a minimum, these commitments should be protected from adverse tax policy changes through transition rules.

Percentage Depletion

- The loss of percentage depletion is the single most serious blow which would be dealt to the mining industry by the Administration's tax proposal.

- Percentage depletion is neither new to the tax code nor used for questionable tax shelter purposes. It has been a part of the law for more than 30 years and is an integral part of mine development economics.

[illegible] ABLE

- Percentage depletion is an incentive for private enterprise to pursue the desirable national goals of energy independence and a strong natural resource base for domestic industry. The above average risks and capital requirements of natural resource development require an appropriate incentive.

- Percentage depletion is the most important tax provision encouraging the orderly development of United States mineral resources and assuring an economically sound domestic mining industry, as called for by the 1970 Mining and Mineral Policy Act.

- Percentage depletion is a sound incentive for mineral exploration and development because it allows tax free recovery of reserve value rather than cost. This reflects the greater expense of developing new reserves.

- It would be inequitable to retain percentage depletion and/or deductions for intangible drilling costs for oil and gas without retaining percentage depletion for coal, which competes against oil and gas as a fuel.

- The economics of existing mineral operations rely upon the percentage depletion allowance. At a minimum, these operations ought to be grandfathered if percentage depletion is eliminated.

Reclamation and Mine Closeup Accruals

- The 1977 Surface Mining Control and Reclamation Act has placed new and expensive reclamation and mine closeup requirements on coal mine operators. These requirements, which do not affect foreign competitors, have made tax provisions reducing the effective cost of compliance very important.

- The 1984 Deficit Reduction Act eliminated most of the advantages of reclamation and mine closeup accrual deductions. A transition rule grandfathered operations where minerals are being sold under pre-existing contracts which could not be changed to reflect loss of the accrual treatment. This protection is equitable and necessary.

- Reclamation accruals were thoroughly evaluated by Congress in the course of amending the tax code in 1984. All parties, including the Treasury Department, worked together in framing the current provisions.

[illegible] AVAILABLE

Senator SYMMS. I think all of you made some excellent points. And I think your statements are a glaring indictment of some of the weaknesses of this proposal that is before the Congress at the present time.

To get specific about the jobs in Idaho and how it would affect—I think, Ken, you were talking—I recall from your statement, you made some comment about, you might not have been mining some of the current property had you known the price of metals. Did you say that?

Mr. SCHMICK. Yes.

Senator SYMMS. That was under the current tax law?

Mr. SCHMICK. That's correct.

Senator SYMMS. If you had this proposal—in other words, Sunshine Mining Co. doesn't have a problem of paying income taxes right now?

Mr. SCHMICK. No, we don't.

Senator SYMMS. So whether the tax rate is 46 percent or 33 is much less important to you than the mitigations against the built-in bias against investment capital?

Mr. SCHMICK. That's correct.

Senator SYMMS. How many people do you think might lose their job if this were put onto you all of a sudden? Would this put you, like, at the mine in Kellogg, that you would have to close it down temporarily?

Mr. SCHMICK. It's dependent upon the market price of silver. If the market stays at its current low rate, it's difficult to talk to a bank to get additional financing.

And with the changing in the tax law, it puts additional burden on you. I'm not sure the banks would talk to you to get the financing and to continue operating the mine.

Senator SYMMS. Well, I mean, the question I would ask you, as a manager of a company, that you would have to also work for the stockholders——

Mr. SCHMICK. That's correct.

Senator SYMMS. You shouldn't be operating in a situation where you have to, every 2 weeks, borrow the money to meet the payroll.

Mr. SCHMICK. It's dependent upon whether the cost of closing the mine or a cash cost of closing an operation and continuing is greater than the cost of shutting it down.

Right now the cost of continuing the operation is less than it would be to shut it down. We're better off now to continue even though we're effectively trading dollars.

Certainly the tax laws in general prohibit us from making any capital expenditures, these tax laws—these proposed tax laws.

Senator SYMMS. So in other words, it would put jobs at risk, then, to do anything right now to make it worse for you?

Mr. SCHMICK. Absolutely.

Senator SYMMS. Now, Lowell, you said you had 100 and how many people working over there now—175?

Mr. SHONK. 390 people currently employed; we expect an increase later this year.

Senator SYMMS. Now, this recapture thing could be devastating, then, to those jobs?

Mr. SHONK. It could impact Cyprus Minterals Co. significantly in that those original deductions from the excess depreciation were taken and used by Amoco Corp. and not by Cyprus. And then Cyprus, after its spin-off, will be forced to pay.

Senator SYMMS. You said $40 million; did I hear you——

Mr. SHONK. $40 million is our most recent estimate.

Senator SYMMS. How long will it take you to make $40 million profit under the current operation?

Mr. SHONK. We expect to be about break-even on a financial book basis in 1985 and, hopefully, if prices are recovering a little bit, to do a little better in years following.

We do not expect in 1986 to be in a tax paying position unless prices improve modestly.

Senator SYMMS. Now, this molybdenum that you are mining over there, most of it is exported. Is that correct?

Mr. SHONK. We export approximately 60 percent of our production.

Senator SYMMS. So that's very important to our trade balance.

Mr. SHONK. That's correct.

Senator SYMMS. Where does that go, most of it?

Mr. SHONK. Europe and Japan, primarily.

Senator SYMMS. I want to ask each of you one question that I have asked every witness that has testified so far, and that is: Which do you think is most important for the Congress to be working on—making changes in the Tax Code or reducing Federal expenditures?

In other words, would you rather we talk about the budget in cutting spending, or would you rather we talk about tax reform? I'll just start down the list. Ken.

Mr. SCHMICK. That's easy. Let's cut some spending.

Senator SYMMS. Lowell.

Mr. SHONK. At Cyprus-Thompson Creek, cost reduction is our bible. We've been working on that ever since we started up operations because we can't do anything about prices. We do a lot about costs.

I think the Federal Government ought to operate on the same basis.

Senator SYMMS. Buzz.

Mr. GERICK. I agree with that, Senator Symms. We, since takeover, have dramatically cut our costs also, and we expect the same from the Federal Government.

Senator SYMMS. Mr. Jones.

Mr. JONES. Exactly the same. I would be surprised if you got a different answer almost anytime.

Senator SYMMS. Well, I think that's an answer that needs to be continually passed on to the administration also. That's one of the reasons why I'm asking every witness that, so that it isn't just me saying that, that I'm hearing it from people, and it's on the record. And I appreciate your answering it.

Congressman Craig, did you have any questions?

Representative CRAIG. No, I don't. But I'm pleased that you explained the complicated and misunderstood—you know, the percentage depletion. A lot of people do not understand it when you're dealing with a nonrenewable resource style of industry. And the importance of allowing that kind of flexibility with an industry to keep it alive and keep it moving, I think that's, to me at least, a valuable part of all of your testimony.

It was in the early days difficult for me to understand until I spent quite a bit of time with it, because I thought, gee, why should this particular industry be allowed advantages that other types of industries were not.

Until you recognize the fact that you're dealing with a nonrenewable, you have to constantly be out acquiring, or assessing for acquiring, or exploring for acquiring additional resources to keep your enterprise alive.

I think that's a valuable part of this testimony and, of course, the Government has recognized that over the years in offering that kind of flexibility. So, to me, that was an extremely valuable part of your testimony, and I have a feeling that when Treasury started crafting new tax law, that there were a lot of folks at the Treasury who don't understand the particular style of industries, and they started looking for areas that were unique in the whole scheme of tax law, or relatively unique, at least from a broad spectrum of taxes levied on business and industry in this country, and thought, aha, opportunity.

Thank you very much for all of your testimony.

Senator SYMMS. Thank you very much, Larry.

And I want to thank all of you. You know, the thing that is so, I think, concerning—and, Buzz, I find myself—I agree with what you said when you made the comment about, that you praise a lot of what the President is trying to get at. I mean, I don't think there is anybody that disagrees with fairness and simplicity. But when President Reagan goes to television and gives one of his speeches, most Americans agree with that. What they don't agree with is the bill that's written down in the bowels of the Treasury by the bureaucrats that work there that are not given the right direction at the top.

And I have to tell you, I told Secretary Baker I'd take this bill back, withdraw it, and rewrite it. Now, I could rewrite it for them, but there is still a bias here.

What you're really saying in the summary of your testimony is that because of the double taxation on any equity financing that you might get where, if you can make a profit, the Government taxes the corporation and then turns around and taxes the dividend, they make a real bias against people investing equity capital in a mining venture.

And then on the other side of the coin—I mean, the bias is so strong against that, that they have to have depletion allowances, ACRS, other kinds of tax benefits to mitigate that hostility against capital increase. And as long as we have that, I think this tax reform proposal is a long ways from passing. No matter what we're hearing out of Washington—I mean, an issue like this, as far as I'm concerned, as a member of the Finance Committee, we'll talk about this in the Finance Committee for a year, if it takes that long, until everybody understands what we're talking about out here, and they just can't move the bill.

Well, you have the same thing on other natural resources. And I don't see how you can recover or reform the Tax Code based on this premise that we're starting out with here without absolutely devastating the viability of the employment of thousands of families in Idaho.

You represent several hundred families here, just of the four of you that are up at the table, that will live and work in Idaho, to expand the whole mining industry. I had the chief executive over at one of Idaho's other large mining companies tell me that the only responsible thing that they could do if their taxes were raised 56 percent—and this is Hecla—he said, "We have to start looking at how much we can operate." He said:

> There is going to be a curtailment of employment because there is no way we can operate and pay 56 percent more taxes and continue to, you know, be holding our cash together right now. And we don't want to be borrowing money to make the payroll. We're cash-flowing right now, but we're doing it with depletion allowance.

Well, to me, that's where the bottom line is, and that will not help the Treasury. Because if they start laying off miners, they'll find out they're not paying taxes. In fact, they'll be taking unemployment. And it just makes the situation worse.

So I really appreciate your testimony. And it will be used by all of the staff. And we thank you very much for your time you spent to give us direct inputs.

All too often we always hear from people back in Washington, but it's good to have it direct from the people in Idaho that will be affected by it.

So thank you very much. We appreciate your being here this morning.

[Whereupon, the panel was excused.]

Senator **Symms**. Now we'll call up Dave Pierson, Idaho Association of Realtors; Richard Nelson, Idaho Association of Life Underwriters; Richard Cooke, American Association of Chartered Life Underwriters; Dave Musko, CPA.

[Whereupon, the panel members assembled.]

Mr. **Browning**. I'm not Dave Pierson.

Senator **Symms**. OK. You are——

Mr. **Browning**. John Browning.

Senator **Symms**. Yes. John Browning. OK.

If any of you have prepared statements, let me have a copy of them, if I could, please.

OK. John Browning is here in place of Dave Pierson.

John, why don't you go right ahead.

I have three—do you have a prepared statement, too?

Mr. **Browning**. Yes.

Senator **Symms**. I don't have one of John's statements.

[Whereupon, a document was handed to Senator Symms.]

Senator **Symms**. Thank you.

Now, as I said, your entire statements will be put in the record. John, you go right ahead.

STATEMENT OF JOHN BROWNING, PRESIDENT, IDAHO ASSOCIATION OF REALTORS

Mr. **Browning**. I am John Browning from Boise, ID, president of the Idaho Association of Realtors. On behalf of the nearly 3,000 members of the Idaho Association of Realtors, we appreciate the opportunity to present these comments on the President's tax proposals to the Congress for fairness, growth, and simplicity.

We regard the President's proposal as revolutionary in its scope with the potential of having devastating effects on the Idaho economy in general and housing in particular. This is not to say that we are opposed to tax reform. On the contrary, we recognize the need for a comprehensive overhaul of the tax structure, but believe the proposals offered to Congress do not achieve the stated purposes of fairness, growth, or simplicity.

We also believe the most critical issue before Congress at this time is not tax reform, but the Federal deficit. We feel the discussion on tax reform will divert the attention of Congress away from the most important issue in our Nation's economic history, the need to reduce and eventually eliminate the deficit.

The housing industry in all of its various forms is one of the largest industries in Idaho. From 1977 through 1984 the industry accounted for nearly $1.9 billion in personal income. More than $250 million in taxes was collected by the various taxing authorities and the industry provided nearly 114,000 man-years of employment.

From analyses conducted by the National Association of Realtors and other independent organizations, it is our conclusion that the proposals intend to finance a personal tax decrease by increasing the tax burden on all types of investment. Since the result of this shift would be to encourage consumption at the expense of investment, Idaho's capital-intensive economy, including timber, mining, agriculture and housing would be seriously impacted.

Idaho's economy is very fragile. We are in a state of out migration. Our growth is due only to our fertility. Our labor force, those who are working, are uncertain about their future. They don't know if they're going to have a job tomorrow. Our industries are uncertain, and our small businesses are confused as to what to do.

There was a time when realtors said, "If we had 10½ to 11½ percent interest rates, we could sell all of the real estate in Idaho." Well, today we have those interest rates, and we're not selling. A lot of people want to sell, but very few people want to buy. They don't know if they will be working tomorrow. That is the problem with this tax reform proposal; it only adds to the uncertainty and exacerbates the problems already plaguing Idaho. Idahoans need jobs a lot more than they need tax reform.

The federal deficit is a major problem for Idaho's economy, and Idaho citizens are helpless to effect a reduction. Only the Congress can do this. The Treasury Department admits that this proposal raises less money; $12 billion less than the current law over the first 5 years. Others indicate this proposal would increase the deficit as much as $100 billion over the first 5 years. This must not be allowed to occur. The Federal deficit must be reduced.

Effects on real estate and home ownership in Idaho, impact of loss of property tax deductibility.—The cost of owning a home would go up while the value of that home would go down. The average annual after-tax cost of owning a home would increase 1.7 percent or about $110, while the average decrease in the value of that same property would amount to about 1.9 percent or $1,120.

The average Idaho citizen accumulates most of his or her wealth in real estate; primarily their family home. This proposal would decrease the value of that home and consequently decrease that citizen's net worth by nearly 2 percent. At the same time, the cost of owning that home would increase. These two factors alone will discourage home ownership.

Some 74.5 percent of Idaho households own their own home, and 75.8 percent of all Idaho households earn less than $30,000 a year. The cumulative impact of increasing the cost of owning a home by $110 a year on 266,756 Idaho homeowners is $29,343,180. That's nearly $30 million in increased costs to Idaho homeowners annually.

The average value of a home in Idaho is $58,000. A 2-percent reduction in value on the 74.5 percent of households who own their own homes would be a cumulative loss in value of $298,766,932. That is nearly a $300 million loss in value to Idaho's homeowners as a result of these proposals.

Impact of loss of mortgage interest deductibility on second homes.—Second or seasonal homes account for more than 20 percent of the residential real estate stock in 47 Idaho municipalities. In some areas, particularly resort areas and rural "bedroom" communities, the percentage of second homes soars to as high as 90 percent.

To accurately predict the actual dollar cost of the proposal to eliminate the mortgage deductibility of interest on second homes is impossible, and we have no access to an econometric model or other data which would allow us to project costs based on averages.

Making the task even more difficult is the proposal to place the second home mortgage interest in the same interest pool as consumer credit, auto loans, and so forth. The amount of mortgage interest which could be deducted would be contingent upon the owner's debt load in other areas and the owner's investment income

Best estimates are that this proposal would reduce the value of second homes on an average of between 20 and 30 percent. Using a hypothetical, in a community with 500 dwelling units, 20 percent of which were second homes, and using the average home cost in Idaho of $58,100, there would be a cumulative loss in value of $1,162,000 using the conservative estimate of a 20—percent decrease in value.

In addition to the loss in value to the second home itself, there would be a resulting loss in value in all residential units in that community and perhaps the county and State. The market is a reflection of the value of all similar units, and any arbitrary loss or gain in value affects all surrounding property.

Using the same hypothetical and extending the loss of value to all residential properties, that community would experience a loss in residential value of $5,810,000.

This has dramatic impact on the property tax collection used by local governments to fund essential services and will be discussed later.

If Idaho's economy has a bright side, it is the tourist industry. And the consequences of this change are unknown, but suffice to say removing an incentive to frequent Idaho as a vacation spot and resort area are counterproductive to our efforts to promote tourism in Idaho.

Impact on rental residential and commercial real estate.—In order for an apartment complex to make sense to an investor under this proposal, the landowner would have to raise rents by about 30 percent. In this market that's not possible, so we just won't have any new apartments nor the construction jobs created to build them.

The average rent in Idaho for nonsubsidized units of all categories is $258. There are 97,094 nonsubsidized housing units in the State. A 30—percent increase in rents for all available nonsubsidized units would create a cumulative rent increase of $7,515,076. In addition, there are 8,321 subsidized rental units in Idaho. In total, 28 percent of Idaho's total population rents ranging from a high of 45 percent in Elmore County to a low of 17 percent in Oneida and Franklin Counties.

Rental residential and commercial real estate investments would become less attractive under the Reagan proposal due to a number of key provisions: reduced depreciation allowances, a change in capital gains treatment, limitations on interest deductions by certain types of investors, extension of the at-risk rule to real estate, and numerous others.

The capital cost recovery system [CCRS] or "crackers" as it is being called, is an absolute about-face from the accelerated cost recovery system [ACRS] adopted at the request of the President just 4 years ago. Already the investment market into structures and real estate has dried up simply because no investor is going to invest his money without knowing what his yield will be or what his tax treatment will be.

CCRS extends the depreciation period from 18 years to 28 years with an adjustment for inflation. At current inflation rates, the CCRS provides only about 60 percent of the depreciation deductions provided by ACRS over a typical 10-year holding period.

Combine this with the proposed changes in capital gains, and real estate investment will dry up.

Idaho is a capital-poor State. We import our money. The question to ask is: Where in Idaho will an investor find a place to put his money if he can't put it into real estate, construction, or commercial structure?

The other question to ask is: Where will we get the money to finance our needs? Who will finance Idaho's growth?

Structures and other depreciable assets will not get equal capital gains treatment with nondepreciable assets such as stocks and bonds. Stocks and bonds will get an effective capital gains rate of 17½ percent. Structures will not get capital gains treatment, but instead will get consideration for inflation. This is blatant discrimination against structures and other long-lived assets.

Extending the at-risk rule to real estate is yet another roadblock to attracting investors into real estate. Real estate is management intensive and risky. An investor looks for the highest yield and the least risk with the least management. Exempting real estate from the at-risk rule served to put real estate investments on equal footing with competing investments.

If that exemption is repealed, we can expect investment dollars to flow into non-real-estate investments which will exacerbate Idaho's traditional problem of attracting investment dollars. The

AVAILABLE

exact economic effect is impossible for us to calculate, but suffice to say it will be significant.

Impact of repeal of tax-exempt bonding authority on Idaho. Idaho's citizens and economy have benefited by the creation of the Idaho Housing Agency. Cumulatively since 1976, the housing activities of the agency have increased Idaho personal income by $350 million, increased the tax revenues to the State by $25.6 million and provided over 19,000 man-years of employment.

The purpose of the agency is to provide decent and affordable housing for limited-income Idahoans. The agency is self-supporting and uses no State funds, tax dollars, or public employees. Through a topic of discussion, numerous reports indicate that the net effect of the Idaho Housing Agency and its counterparts in other States is a positive cash-flow into the Federal Treasury as well as the various State treasuries as a result of increased economic activity.

Idaho ranks 34th in median household income, with the median income per household being $15,285. We rank 38th in per capital income at $7,298 annually. 53.3 percent of our population has an annual household income of less than $20,000, 39.9 percent have annual incomes of less than $15,000, and 24.7 percent have annual household incomes of less than $10,000.

Without the Idaho Housing Agency, or some better method of providing shelter, a significant portion of Idaho's citizens would be without the ability to purchase a home, and perhaps without the ability to rent.

Impact on Idaho's property tax structure. The impact of this proposal on Idaho's local units of government is of vital concern to us. Under Idaho's constitution, local units of government have only one means to raise revenue: property tax. The State legislature can extend limited authority for taxation to cities and counties but so far have been unwilling to do so. Idaho's average property tax rate statewide is 1.02 percent. Using the loss in value figure mentioned earlier of $298,766,932 for all residential properties, local taxing districts would lose $3,046,413.

On that hypothetical 500 housing unit community mentioned above, the tax loss would be $296,310. This kind of tax loss would devastate many of our small communities with a high percentage of second homes.

This combined loss of value would severely restrict the ability of school districts, fire districts, cities, counties, and other local taxing districts to provide services.

This could also impact the State treasury. As local taxing districts lose their ability to pay for services, they would look to the State for help. Hence, either the State would have to allow the local taxing districts additional taxing authority or the State itself would have to increase taxes to pick up the slack, in either case adding to an already overtaxed population.

In conclusion, we have not attempted nor will we be able to address every aspect and their impacts of the President's tax reform proposal. Instead, we have tried to look at those which most directly affect the shelter industry in Idaho. We've attempted, within our available resources both in expertise and information, to project the impact of the various proposals. We recognize that this tax reform effort is a system and that to properly analyze it, you must look at the entire package for offsetting impacts.

I urge you to look closely at analyses being conducted by the National Association of Realtors and other organizations and independent agencies. We understand the need for tax reform and support the concept. We sincerely feel, however, that the package before us today does not meet the objectives sought by the President. It is not fair, it is not simple and it will not promote growth.

Senator SYMMS. Thank you very much, John.

Mr. Nelson.

STATEMENT OF RICH NELSON, NATIONAL COMMITTEEMAN AND LEGISLATIVE CHAIRMAN, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, AND LOBBYIST, BLUE CROSS OF IDAHO

Mr. NELSON. Gentlemen, Senator Symms——

Senator SYMMS. Just go right ahead.

Mr. NELSON. I have provided for you an outline of my testimony. There are basically five areas—six areas covered in that testimony. I would like to address only three of those this morning.

My name is Rich Nelson. I represent the National Association of Life Underwriters in the position of national committeeman and legislative chairman. I am also the lobbyist for Blue Cross of Idaho, the largest carrier in Idaho with some 243,000 members.

It is our opinion the 133,000 colleagues that make up the National Association of Life Underwriters—we believe that we would be severely damaged by the Reagan administration tax proposal in its present form.

I'd like to address first of all the area of deductibility of interest. The Reagan tax reform plan proposes an annual limit on interest paid on debt not incurred in connection with a trade or business. The limit proposed is $5,000, or $2,500 for a married person filing a separate return, plus an amount equal to the taxpayer's net investment income.

The interest paid on a mortgage on the taxpayer's principal place of residence would be exempted from this annual limit.

The Life Underwriters oppose the idea of limiting the deductibility of interest on consumer loans. A limit on the deductibility of consumer interest would set up a tax-tilted competition among forms of debt. The limit would conflict with the major thrust of the Reagan tax reform plan, that is, to eliminate tax-motivated transactions.

We believe life insurance to be a necessity, like housing, and we believe it is perceived as such by the general public. It would be unfair to put home ownership at a tax advantage over other essentials, such as insurance, food, and clothing.

The interest limit will have a retroactive effect on the existing debt and interest obligation of policies. This indeed would be harsh for some, for it would mean replacing existing contracts with lesser perhaps inadequate amounts of permanent coverage.

For others who may by then be uninsurable, the results would be even worse. Those people would not have the option to buy less new coverage. Their choice would be limited to surrendering their financed insurance and living with an unmet insurance need, or somehow finding a way to pay the extra cost from other sources.

The second area I'd like to address is taxing employee benefits. The Reagan tax reform proposal suggests subjecting the first $120 or $300 of employer-provided health insurance to income tax. Administration officials, including Treasury Secretary Baker, concede that this floor approach has problems and say they would prefer a cap approach; that is, a ceiling above which the value of one or more now tax-free employer-provided benefits would become subject to income tax.

Life underwriters questions the wisdom of taxing employer-provided benefits either way. Whether a floor or a cap, or something in between, whether imposed on health insurance alone or on all basic employee benefit plans, there are many reasons why taxing employee benefits would be a bad tax policy and a bad social policy.

First, the employer-provided benefits constitute a financial safety net that, in basic form, is vitally important to most working Americans.

Second, few, if any, of the calls for increased tax fairness and/or simplicity contemplate imposing tax liability on working class Americans who already feel overburdened by the tax load.

Third, employee benefit packages are an important element of overall compensation, compensation that consists of salary-plus-benefits can usually be counted on to be superior to compensation that consists only of salary.

Fourth, benefit packages provide flexibility in compensation plan design.

Fifth, the imposing of tax liability, partial or total, on the value of employer-provided benefits would decrease, and probably dramatically, the level of protection in force and thus also tend to increase the pressure to expand governmental and other assistance programs.

Finally, the truth is, 96 percent of all employees of medium and large-sized employers have employer-provided group health insurance programs. Tax-free health insurance cannot in any justifiable sense be considered a tax loophole serving a special interest, nor——

Senator SYMMS. Ninety-six percent?

Mr. NELSON. Ninety-six percent. Nor can any threat to its continued viability be tolerated without real fear for the adverse consequences. As a practical matter, given the university—excuse me, universality of health insurance protection, the Reagan proposal can be viewed only as a thinly-disguised tax increase, especially for middle-income Americans.

The last area I'd like to address is section 410(k) plans. These retirement savings plans are growing increasingly popular among all sizes of employers, primarily because of employer matching contributions. Section 410(k) plans are a form of defined contribution pension plans, and thus subject to the defined contribution plan annual contribution limit of $30,000 or 25 percent of compensation.

Many organizations, including the National Association of Life Underwriters and Blue Cross of Idaho, participate in such plans.

The Reagan plan proposes to limit the annual contributions to 401(k) plans to $8,000, minus the amount contributed to an IRA.

Not only would this single out the most popular of all defined contribution plans, it would also discriminate against those who have spousal IRA's, because their IRA contributions could limit their permissible level of contribution to 401(k) plans to half the amount that could be contributed by those without spousal IRA's, also coupling limits on 401(k) and IRA contributions, the only such coupling in the pension planning area.

The proposal as drafted could create an administrative nightmare because 401(k) plan contributions are elected at the beginning of a tax year, while IRA contributions can be made as much as 15½ months later. This timing disparity could cause monumental problems.

In addition, the Reagan proposal would apparently prohibit 501(c)(6) trade associations and nonprofit organizations such as Blue Cross of Idaho from having such 401(k) plans.

In conclusion, for the reasons that I have outlined, plus the important factors that Mr. Cooke will discuss concerning Mr. Reagan's tax plan, the proposal's adverse effects on our business and on the security of our clients would make the price for lower tax rates just too high to pay.

From a life insurance perspective, the Reagan tax reform plan appears more complicated, more unfair and would fall short of its goal of stimulating economic growth. Worse, it would severely damage our industry and the people it serves.

We do not believe this plan is truly reform. Reform means to improve by change. This plan would not improve anything; it would, however, bring change which we feel would not be in the best interest of the insuring public.

Thank you.

Senator Symms. Thank you very much.

[The prepared statement of Mr. Nelson follows:]

PREPARED STATEMENT OF RICH NELSON

Mr. Chairman, members of the Committee, I am Rich Nelson, National Committeeman and legislative chairman for The National Association of Life Underwriters and lobist for Blue Cross of Idaho, the largest carrier in Idaho representing 243,000 Idaho members. Today I am with Richard E. Cooke, a Representative of the American Society of CLUs. We represent 2,000 affiliated career life and health insurance salespeople in Idaho. We are local representatives of the 133,000 member national organization known as NALU. In our opinion, nationally, our millions of clients as well as our 133,000 colleagues would be severly disadvantaged by the Reagan Administration's tax proposal in its present form.

Mr. Cooke will express our concerns on one of the most destructive features of the Reagan proposal - the plan to tax as income the increasing cash value buildup within life insurance policies. First, however, I would like to outline five other features of the Reagan tax proposal that we consider to present equally serious problems.

I. Deductibility of Interest.

The Regan tax reform plan proposes an annual limit on interest paid on debt not incurred in connection with a trade or business. The limit proposed is $5,000 ($2,500 for a married person filing a separate return), plus an amount equal to the taxpayer's net investment income. The interest paid on a mortgage on the taxpayer's principal place of residence would be exempted from this annual limit. Generally, the limit would be effective for interest expenses paid or incurred on or after January 1, 1986. Two transition rules allow a phase-in of fully limited interest deductibity.

Life underwriters oppose the idea of limiting the deductibility of interest on consumer loans. A limit on the deductibility of consumer interest would set up a tax-tilted competition among forms of debt. The limit would conflict with the major thrust of the Reagon tax reform plan, i.e., to eliminate tax-motivated transactions. We believe life insurance to be a necessity, like housing, and we believe it is perceived as such by the general public. It would be unfair to put home ownership at a tax advantage over other essentials, such as insurance, food and clothing.

This limitation would also encourage the restructuring of debt, so that the bulk of indebtedness would wind up connected with home mortgages. Restructuring of debt to take advantage of the principal residence "loophole" would cleartly brand this part of the tax plan as consisting of form, not substance. Debt restructuring could be perilous to the country to the extent that is could lead to an over-abundance of over-mortgaged principal residences, which, in an economic downturn, would be widely subject to foreclosure.

Despite two transition rules, the interest limit will have a retroactive effect on existing debt and interest obligations. It is always unfair and could be harmful to change the rules on anyone in midstream. People who are relying on financial planning done in good faith under existing law could find themselves suffering heavy economic losses if this rule were allowed to be imposed retroactively. This is of particular concern to those who have financed life insurance plans.

With reference to life insurance, policy loans are often the only way people can keep needed protection in force during temporary economic hard times. It is during those same hard times that the limit on interest deductibility will be hardest to bear. Thus, the limit could result in loss of coverage and protection.

The right to borrow on a life insurance policy is often a major persuasive factor in the decision to purchase an adequate amount of permanent insurance. The basic appeal of life insurance is its long-term promise of financial security at retirement or in the event of premature death. In return, a sound life insurance program calls for a long-term financial commitment for the policyholder. Many -- in fact, most -- prospective policyholders can with comfort determine that the annual premium for the amount of insurance they need is affordable at the time of applying and in the foreseeable future. But they worry about the possibility of the times of financial hardship that can befall many of us. The ability to borrow from their policies in the event of those hard times becomes a key factor in their decision to make the long-term financial commitment that is necessary to the success of the program. And it is important to note that in many cases the sale is made because of the option to borrow, but actual borrowing may never in fact occur.

Any life underwriter could cite numerous examples of the near-daily working of the importance of the policy loan feature. For now, let one illustration suffice: consider a 35-year-old man who has agreed that he needs a $200,000 permanent life insurance policy. He believes he can afford it at present. However, he's less than certain that the premiums required will continue to be affordable for the 30 years or so that premiums will have to be paid before the major planned-for event, retirement, occurs. He is inclined to purchase only $100,000 of insurance at present, so that he can be more certain of the finanial ability to keep the policy in force. But, armed with the knowledge that should those financial hard times occur he will be able to borrow from his policy, deduct the interest on the loan, and thus keep the policy in force, he is convinced to go ahead with the purchaes of the entire amount of coverage he really needs.

In actual fact, this policyholder, like most policyholders, will borrow only minimally or not at all from his policy. And he will repay the loan. But the policy loan feature has motivated a decision that could not as safely have been made in the absence of that feature. Limiting the right to deduct interest would take away one sound reason for buying adequate permanent insurance.

Because the policy loan feature motivates the purchase of permanent insurance vastly more often than acutal borrowing results, its limitation would act to depress much more than tax-leverage borrowing. In the aggregate, such a limit would result in even more underinsurance in the population, creating greater potential for expensive government programs to fill the gap. This would also substantially reduce the inflow of capital to the nation's economy. with our national savings rate at only 6.1%, America can ill-afford any substantial reduction in capital-developing capacity. And the deficit-ridden federal budget cannot bear the cost of more social programs, or greater levels of benefits under Social Security. Yet, to the extent that his provision -- or any new tax law -- would act to inhibit the private sector's ability to provide financial security and capital formation, it would create the potential for just such pressure on the federal government.

The Regan interest deduction limit would have other harmful effects. We believe it would stimulate lapsation of coverage among current policyholders who purchased life insurance contracts on the basis of the option fo finance them. For these people, enactment of the proposal may present a choice between maintaining a policy they may not be able to afford without the deductibility of interest on policy loans, or surrendering their policies. This would be harsh indeed. For some, it would mean replacing existing contracts with lesser, perhaps inadequate amounts of permanent coverage. For others who may by then be unisurable the result would be even worse. Those people would not have the option of buying less new coverage. Their choice would be limited to surrendering their financed insurance and living with an unmet insurance need, or somehow finding a way to pay the extra cost from other sources.

II. Taxing Employee Benefits.

The Regan tax reform proposal suggests subjecting the first $120 or $300 of employer-provided health insurance to income tax. Administration officials -- including Treasurey Secretary Baker -- concede that this "floor approach" has problems and say they would prefer a "cap approach;" i.e., a ceiling above which the value of one of more now tax-free employer-provided benefits would become subject to income tax.

Life underwriters question the wisdom of taxing employer-provided benefits either way. Whether a floor or a cap, or something in between; whether imposed on health insurance alone or on all basic employee benefit plans, there are many reasons why taxing employee benefits would be bad tax policy and bad social policy.

First, employer-provided benefits consitute a finacial safety net that, in basic form, is vitally important to most working Americans. Second, few if any of the calls for increased tax fairness and/or simplicity contemplate imposing tax liability on working class Americans who already feel overburdened by the tax load. Third, employee benefit packages are an important element of overall compensation. Compensation that consists of salary-plus-benefits can usually be counted on to be superior to compensation that consists only of salary. Fourth, benefit packages provide flexibility in compensation plan design. Fifth, the imposition of tax liability -- partial or total -- on the value of employer-provided benefits would decrease -- and probably dramatically -- the level of protection in force, and thus also tend to increase the pressure to expand government and other assistance programs.

Taxing health insurance to employees would be a threat to what is now an effective and efficient health insurance system. To tax all or part of an employer-provied health care benefit would be to ignore that in well over half of today's families both spouses work, and both spouses are covered by employer-provided health insurance. This "double coverage" could generate a discriminatory tax liability, expecially if the floor approach is enacted. One thinks of situations where tax would be paid by both spouses, but coverage for claims may only be available under one or the other plan.

Further, to the extent that employees -- especially younger, less well-paid employees -- incure taxable income, they may, given the choice, choose to reject health insurance coverage. This would pose a significant danger. Like the two-employee family, the conparatively young, healthy worker who opts out could upset the discrimination rule calculations. He or she could also contribute to adverse selection, the process that occurs when people who are unlikely to need the protection drop out of a plan, leaving those more likely to present claims. Higher expenses would then drive up costs, perhaps to a prohibitive level.

In this connection, one reason advanced by the Treasury for taxing employee benefits is that people with them are getting what the Treasury Department believes is a "free ride," vis-a-vis people without these benefits. But to tax those benefits would, as we have said, only cause people to drop out, and thus add to the rolls of people without benefits, only exacerbating the social problems associated with lack of coverage.

Each formulation of taxable health insurance has its own problems. A cap would discriminate against high-cost economic areas (e.g., New York, California) and certain groups of people (e.g., older work forces; predominantly female work forces; work forces in high risk occupations). A cap would discourage cost-effective coverages like preventive care, second opinions, and dental or vision care. A floor would add yet more tax weight on the backs of the working class, while serving public policy very little if at all.

Finally, the truth is, because 96% of all employees of medium and large size employers have employer-provided group health insurance protection, tax-free health insurance cannot in any justifiable sense be considered a "tax loophole serving a special interest." Nor can any threat to its continued viability be tolerated without real fear for the adverse consequences. As a practical matter, given the universality of health insurance protection, the Reagan proposal can be viewed only as a thinly-disguised tax increase, especially for middle income Americans.

III. Section 410(k) Plans.

These retirement savings plans are growing increasingly popular among all sizes of employers, primarily because of employer matching contributions (only about 12% of the eligible people, by contrast, have IRA's). Section 401(k) plans are a form of defined contribution pension plan, and thus subject to the defined contribution plan annual contribution limit of $30,000 or 25% of compensation. Many organizations -- including NALU, and Blue Cross of Idaho, themselves small employees -- exempt from tax under IRC 501(a) and 501(c) maintain 401(k) plans for their employees. These plans are subject to strict nondiscrimination rules and early withdrawal restrictions.

The Reagan plan proposes to limit annual contributions to 401(k) plans to $8,000, minus the amount contributed to an IRA. Not only would this single out the most popular of all defined contribution plans for new, severe limitations, it would also discriminate against those who have spousal IRAs, because their IRA contributions could limit their permissible level of contribution to 401(k) plans to half the amount that could be contributed by those without spousal IRAs. Also, coupling limits on 401(k) and IRA contributions -- the only such coupling in the pension planning area --creates unnecessary complexity for no apparent justification, especially given the fact that only 12% of the population have IRA. Further, the proposal as drafted could create an administrative nightmare because 401(k) plan contributions are elected at the beginning of a tax year while IRA contributions can be made as much as 15 months later. This timing disparity could cause monumental problems. In addition, the Reagan proposal would apparently prohibit 501(c)(6) trade associations like NALU and non-profit organizations like Blue Cross of Idaho from even having 401(k) plans. To the extent that many such organizations do not qualify for the other tax-favored retirement savings plans available to governmental and educational employers [501(c)(3) entities], the proposal is discriminatory.

IV. Qualified Plan Rules.

The Reagan proposal would "simplify" pension law by totally rewriting the technical distribution and contribution rules. Whether the proposed changes would in actual fact be simpler than current law is debatable. But any change as complex as these proposals is bound to add complexity, at least in the short run.

Generally, the Reagan plan would impose penalty taxes on early and late distributions, on plan terminations, and on "excess" payments received by a plan's retired participants. Setting aside the question whether these changes represent sound public policy, they would be the fourth set of major law revisions since 1982, and would represent yet another obligation on the part of employers to amend existing plans.

We believe patience with the unending streams of changes in technical rules governing qualified plans has virtually run out. Complexity that is in place and understood is preferable to changes that may or may not be simpler, but must be analyzed and implemented -- at substantial cost. There is a frightening and growing feeling among the clients of our members that the administrative cost of maintaining pension plans which have to be changed in a major way on a nearly annual basis outweighs many of the benefits these plans provide. This is particularly true in the case of small employers who must pay outside administrators for each of these changes, and for whom the cost per employee is much higher. And higher administrative costs limit the resources available for retirement benefits. Increasing resources used for administrative purposes is not a worthy social or economic goal.

The promulgation of further changes in these rules -- before we have had a chance to see if the current rules work -- will surely have a chilling effect on the establishment of new plans and the maintenance of existing ones.

V. Discrimination Rule.

The proposed uniform discrimination rule is an attempt to apply one rule to all employers and all tax-free employer-provided benefits. However, this attempt at simplicity has sacrificed fairness. The proposal's suggestion that key employees never be allowed to receive more than 125% of the benefits provided other plan participants would make it impossible for a very small employer to provide benefits at all. An individual employee's decision to reject any given benefit -- an inescapable possibility if benefits become totally or partially subject to tax -- could destroy a plan's ability to satisfy the discrimination requirements.

The carrot held out in the proposal that authority might be given to the IRS to grant waivers and impose alternative discrimination rules of its own design is anything but reassuring. From our perspective, the IRS has not been known for its timely, even-handed implementation of Congressional intent.

In short, if a uniform discrimination rule is desirable, such a rule needs to be more definitive and at the same time more flexible and thus responsive, particularly to small employer needs, than the one described in the Reagan plan. To accept a rule such as this one would create the danger that employers with fewer than 25 or so employees may find themselves legislated out of the field of offering tax-free benefits to their employees.

VI. Company Taxation.

Finally, in addition to expressing our concern about the policyholder issues, we want to add our support to our companies' position on the provisions governing life insurance company taxation. While we, as representatives of agents, are not specialists in corporate tax law, we are responsible for evaluating corporate tax law's impact on the saleability of life and health insurance. To the extent the tax law influences the price of the life insurance product, it does affect saleability. Thus, we support our companies' evaluation of the life insurance reserve and special deductions proposals.

Conclusion.

For the reasons I have outlined, plus the important one that Mr. Keenan will discuss, life underwriters cannot support the Reagan tax plan. The proposal's adverse effects on our business and on the security of our clients would make the price for lower tax rates just too high to pay. From a life insurance perspective, the Reagan tax reform plan appears more complicated, more unfair, and would fall short of its goal of stimulating economic growth. Worse, it would severely damage our industry and the people it serves.

We do not believe this plan is truly "reform." "Reform" means to improve by change. This plan would not improve anything; it would, however, bring change which we feel would not be in the best interest of the insuring public.

In summary of our sentiment with respect to the Reagan plan, let me just say, Mr. Chairman, that if this is tax reform, we're against it.

Thank you. Mr. Keenan will now discuss the proposed taxation of the inside buildup in life insurance policies.

Senator SYMMS. Mr. Cooke, welcome to the committee.

STATEMENT OF RICHARD E. COOKE, PRESIDENT, BOISE VALLEY CHAPTER, AMERICAN SOCIETY OF CHARTERED LIFE UNDERWRITERS

Mr. COOKE. Senator Symms, gentleman, my name is Richard Cooke. My position here is president of the Boise Valley Chapter of the American Society of Chartered Life Underwriters.

The American Society of CLU's is the organization of CLU and ChFC alumni who have gathered together for the purpose of promoting continuing education among those holding the CLU and ChFC designations, as well as the quality of ethics and integrity in the insurance industry.

The Boise Valley Chapter of CLU's and the Idaho Association of Life Underwriters represent the life insurance agents in the State of Idaho who write over 90 percent of the individual life insurance written in the State.

And that's relating to Mr. Nelson's position here as representing the Life Underwriters Association.

I have been in the life insurance business in the Boise area for over 24 years. During that time, I have sold literally thousands of the kind of life insurance policy that would be adversely affected if the President's proposal is allowed to become law.

There are several points in the President's proposal that affect, directly, the insurance industry. I will be speaking on one of those issues which we feel is probably the most devastating to the insurance industry. Mr. Nelson has taken over some of the other ones that, important as they are, don't seem to be quite as devastating as the one I will be speaking about.

As we understand the President's plan, a policyholder would include in interest income for a taxable year any increase during the taxable year in the amount by which the policy's cash surrender value exceeds the policyholder's investment in the contract. A policyholder's investment in the contract would be equal to the aggregate of his gross premiums, reduced by the aggregate policyholder dividends and other distributions under the policy and by the aggregate cost of renewable term insurance under the policy. This is commonly referred to as taxing the inside buildup of cash values of a whole life policy.

This would mean that for the first time, owners of life insurance policies would be treated as being in constructive receipt of the cash value of their policies. I think, Mr. Chairman, that the history and development of cash-value life insurance needs to be reviewed and understood in considering whether an income tax on cash value is justified.

I will not go into a long, historical background but briefly stating that it has been said earlier in testimony before other committees, cash value life insurance developed out of the desirability, if not the necessity, of providing a level premium for the duration of a life insurance contract. The vitality of the level premium has been described, and I have lifted a paragraph there out of the "Life Insurance Handbook," and I'll leave that in the record.

The cash value of a policy, therefore, has its origin in the excess premiums charged in the early years of the contract to keep the premium level over the life of the policy.

In fact, it used to be that policies contained no provision for payment of amounts representing an insured's equity upon termination prior to maturity. The law did not generally require policies to have a cash value until after the turn of the century. Cash values are not savings or investments in concept, but rather they grew out of public policy against full forfeiture upon lapse and the desire to establish a basis whereby the purchaser, on early termination, could recover some of the payments already made. However, unless and until surrender occurs, the policy's cash values represent a continuing accumulation of death benefit.

It is on this point that we draw your attention to the legal analysis of the Treasury's proposal to tax currently cash value accumulations. This Congressional Research Service study, prepared by Robert B. Burdette and released June 11, 1985, points out that the Treasury proposal raises important legal due process questions.

As Mr. Burdette indicates, cash values are an accumulation of death benefits, at least until the policyholder transforms them into investment by surrendering all or part of the future death benefit and concurrently receiving the cash value attributable to that amount of foregone death benefit.

As you know, under existing law, this action, the withdrawal that transforms cash values from death benefit to investment, triggers a taxable event governed by laws and regulations which were studied in depth during the writing and enactment of the 1984 Life Insurance Tax Act.

And Mr. Burdette in there states some of it, and I will just leave that for the record, his quote, and go on from there.

Nonetheless, in an ancillary sense, and because some policies are terminated prior to death, most often at retirement, the cash value buildup of a permanent life insurance policy has long since been recognized as serving a socially desirable savings and investment function. Thus, in addition to providing a means whereby level annual premium products can stay in force at the upper ages, and a mechanism for the orderly accumulation of death benefit, cash values sometimes are transformed into a form of savings.

It is true that the savings aspect of permanent life insurance engenders benefits in addition to the primary benefit of life insurance, the preservation of the economic human life value of the insured for his beneficiaries.

The cash value element of life insurance also affords purchasers additional valuable features like policy loans, automatic premium loans, extended term insurance to prevent lapse, as well as the right to purchase annuities in accordance with policy settlement options.

Such settlements are, of course, taxed under current law as received. In addition to providing a guaranteed face amount, the cash value life insurance policy has thus evolved into a contract embodying a significant bundle of complementary policyholder options, none of which can really be said to predominate in importance over others, but all serving important needs at various times.

This, gentlemen, would be an age-indexed tax. The operation of the cash value tax would work harshly against older policyholders. As the years pass, annual cash value increases become larger. As policyholders age, the cost of term insurance protection, which decreases the investment that offsets taxable increases in cash values, increases dramatically.

The end result would be much greater tax liability during a policy's later years. Thus, the very purpose of whole life insurance—that is, the employment of a level premium structure to keep life insurance affordable at older ages—would be undone by the imposition of a tax that would have the effect of making the policy more expensive every year.

The tax obligation imposed on a policy under the Reagan plan could indeed exceed the premium as the policyholder nears retirement age. For example, a $40,000 whole life policy with a level annual premium of $535 issued to a 35-year-old male, would generate taxable income of $1,098 at the policyholder's age of 55.

And by age 75, the same policy would generate taxable income of $1,644. In fact, industry actuaries have estimated that the average policyholder would pay some $5,800 in additional taxes over the policyholder's lifetime if the Reagan proposal to tax cash values were to be enacted.

Cash values hedge against Social Security overexpansion.—Life insurance, both temporary and permanent, have always played a most vital role in meeting the income security needs of people, and by doing so reduces the pressure on the Social Security system to provide ever higher and broader levels of benefits. Both permanent and term insurance provide benefits for survivors of breadwinners. Only permanent forms of insurance, however, provide survivor benefits at more advanced ages, as well as retirement benefits for breadwinners at retirement.

In view of the troubled financial state of Social Security during the last decade, this is not the time, in our judgment, to do anything to discourage people from acquiring permanent insurance. The decisions that might be made today which would have that effect won't show up as adverse results for many years. And the Congress knows only too well the difficulty of projecting the future financial position of Social Security, try as it might. If, as some Social Security experts suggest, long-range projections are off by only a small percentage, huge shortfalls in revenue may result.

Private funds may then be the only bulwark against future Social Security benefit increases. It would be catastrophic if tax policy-induced cutbacks in the retirement benefits of permanent insurance began showing up at the same time.

Cash values are a source of capital.—Taxation of the increasing cash values of life insurance would also depress a proven source of needed investment capital. In 1984, life insurance companies provided more than $64 billion for investment in the economy of the country.

To walk through a life insurance company's investment department is to walk down the Main Street of most cities and towns, even here in Idaho, as well as America.

The telephone wires reflect investment in utilities. The shopping mall with its dozens or hundreds of jobs well might be financed at least in part by mortgages held by life insurance companies. Housing construction is made possible through resources held by life insurance companies. Life insurance company assets at work are reflected in corporate bond investments of well over $200 billion, mortgages of almost $150 billion, and corporate stocks in excess of $40 billion.

These primarily long-term investments are made possible because millions of policyholders are willing to commit themselves for long periods of time to cash value life insurance. According to the Life Insurance Fact Book of the American Council of Life Insurance——

Senator Symms. I don't like to—I want to hear everything you have to say, but we are pressed just a little bit. If you could kind of summarize. It's all going to be part of our record.

Mr. Cooke. All right. There is—skipping over to capital, there's one thing on that page——

Senator Symms. If you have a point or two you want to make, go right ahead. I don't want to cut you off.

Mr. Cooke. It's under constructive receipt. Under present law, amounts credited to the cash value of a life insurance contract are taxed only when withdrawn, and only to the extent the withdrawals exceed the aggregate premiums paid by the policyholder for the contract.

And skipping through that quickly, there is no constructive receipt of cash values of life insurance. There is analyses and analogies made in this testimony that you will be able to read of relating those to the increase in value of a diamond and also the increase in value of one's home. And one is not taxed on the increase in value of property that he does not realize a constructive receipt of.

And the same is applied here, is that there is no constructive receipt and, therefore, there should be no taxation done on something where there is no constructive receipt.

The other point that I would like to make is that this issue has been dissected and hashed by Congress in the last few years and was settled just last year in the Life Insurance Tax Act of 1984. And this issue at that time was agreed upon by Congress and the administration and has had less than 6½ months since becoming a law to even see if it's going to work, and here it is coming up again.

Senator Symms. That's an excellent point.

Mr. Cooke. That is also in my concluding remarks there.

And I believe, by way of just winding it up, that there is some legal problems, and there is some constructive receipt problems. Congress has already spoken on this. Industry and Congress did come together on the Life Insurance Tax Act and agreed on what should be done with it. And now it's being brought up again.

And all this, according to Treasury Department figures, the proposal has no revenue effect until 1990, and then only $200 million. Even Secretary Baker has testified that this proposal is driven by policy and has little or no revenue considerations attached to it.

And for those reasons, Mr. Chairman, we would like to submit this testimony that we feel that your vote against this would be appropriate.

[The prepared statement of Mr. Cooke follows:]

AVAILABLE

PREPARED STATEMENT OF RICHARD E. COOKE

Mr. Chairman, I am Richard E. Cooke, President of the Boise Valley Chapter of the American Society of Chartered Life Underwriters. The American Society of CLU's is the organization of CLU and ChFC alumni who have gathered together for the purpose of promoting continuing education among those holding the CLU and ChFC designations, as well as the quality of ethics and integrity in the insurance industry. The Boise Valley Chapter of CLU's and the Idaho Association of Life Underwriters represent the life insurance agents in the state of Idaho who write over 90% of all life insurance written in the state. I have been in the life insurance business in the Boise area for over 24 years. During that time I have sold thousands of the kind of life insurance policy that would be adversely affected if the President's proposal is allowed to become law.

There are several points in the President's proposal that effect, directly, the insurance industry. I will be speaking on one particular proposal which we feel is probably the most devastating to the insurance industry. Mr. Richard Nelson, representing the Idaho Association of Life Underwriters, will be speaking about the other portions of the President's proposal that we feel strongly about.

As we understand the President's plan, a policyholder would include in interest income for a taxable year any increase during the taxable year in the amount by which the policy's cash surrender value exceeds the policyholder's investment in the contract. A policyholder's investment in the contract would be equal to the aggregate of his gross premiums, reduced by the aggregate policy holder dividends and other distributions under the policy and by the aggregate cost of renewable term insurance under the policy. This would mean that for the first time owners of life insurance policies would be treated as being in constructive receipt of the cash value of their policies.

I think, Mr. Chairman, that the history and development of cash value life insurance needs to be reviewed and understood in considering whether an income tax on cash value is justified.

Function of Cash Value. As has been said in earlier testimony to other committees, cash value life insurance developed out of the desirability if not the necessity of providing a level premium for the duration of a life insurance contract. The vitality of the level premium has been described as follows:

> "The chief significance of the level premium concept lies in the fact that the redundant premiums in the early years of cash value contracts create a fund which is held by the insurer for the benefit and to the credit of the policyowners. Earnings (principally interest) are produced by investing the fund. The accumulated fund, improved by earnings, is used to pay out the benefit amounts provided for under the contract. Thus, the level premium is the only arrangement under which it is possible to provide insurance protection to the uppermost limits of the human life-span without the premium per unity of face amount increasing as age advances and eventually becoming prohibitive for most individuals." [Life and Health Insurance Handbook, 1973]

The cash value of a policy therefore has its origin in the excess premiums charged in the early years of the contract to keep the premium level over the life of the policy.

In fact, it used to be that policies contained no provision at all for the payment of amounts representing an insured's equity on termination prior to the maturity of the policy. The law did not generally require policies to have a cash value until after the turn of the century. Cash values are not 'savings' or 'investment' in concept, but rather they grew out of public policy against full forfeiture upon lapse and the desire to establish a basis whereby the purchaser, on early termination, could recover some of the payments already made. However, unless and until surrender occurs, the policy's cash values represent a continuing accumulation of death benefit.

On this point, we draw to your attention the legal analysis of the Treasury's proposal to tax currently cash value accumulations. This Congressional Research Service study, prepared by Robert B. Burdette and released June 11, 1985, points out that the Treasury proposal raises important legal due process questions. As Mr. Burdette indicates, cash values are an accumulation of death benefits, at least until the policyholder transforms them into investment by surrendering all or part of the future death benefit and concurrently receiving the cash value attributable to that amount of foregone death benefit. As you know, under existing law this action -- the withdrawal that transforms cash values from death benefit to investment -- triggers a taxable event governed by laws and regulations which were studied in depth during the writing and enactment of the 1984 life insurance tax act.

As Mr. Burdette phrases it,

> "In the situation where the proposal results in an over-inclusive measure of taxable income (i.e., where it requires "too much" to be included in a policyholder's gross income by requiring that policyholder to include amounts never actually received), the over-inclusiveness derives from the application of a fiction of law. According to that fiction, every year the policyholder is presumed to receive the net increase in

BEST COPY AVAILABLE

> inside buildup for that year regardless of whether or not the policyholder actually ever receives it. In effect, the proposal presumes that every policy is eventually surrendered. Obviously, everytime a policy matured, that presumption would be contradicted by fact. The factual wrongness of the presumption in such instances and the consequently perceived legal "wrongness" of (i.e., "injury" worked by) imposing a tax burden on the basis of such a faulty presumption raise fundamental due process concerns." ("A Legal Analysis of the Treasury Department's Rationale for Its Proposed Method of Taxing the So-Called 'Inside Buildup' under Certain Life Insurance Contracts," Congressional Research Service, Library of Congress, Robert B. Burdette, Legislative Attorney, American Law Division, June 11, 1985, pp CRS-34,35)

Nonetheless, in an ancillary sense, and because some policies are terminated prior to death (most often at retirement), the cash value buildup of a permanent life insurance policy has long since been recognized as serving a socially-desirable savings and investment function. Thus, in addition to providing a means whereby level annual premium products can stay in force at the upper ages, and a mechanism for the orderly accumulation of death benefit, cash values sometimes are transformed into a form of savings.

It is true that the savings aspect of permanent life insurance engenders benefits in addition to the primary benefit of life insurance -- the preservation of the economic human life value of the insured for his beneficiaries. The cash value element of life insurance also affords purchasers additional valuable features like policy loans, automatic premium loans, and extended term insurance to prevent lapse, as well as the right to purchase annuities in accordance with policy settlement options. Such settlements are, of course, taxed under current law as received. In addition to providing a guaranteed face amount, the cash value life insurance policy has thus evolved into a contract embodying a significant bundle of complementary policyholder options, none of which can really be said to predominate in importance over others, but all serving important needs at various times.

This Would Be An Age-Indexed Tax. The operation of the cash value tax would work harshly against older policyholders. As the years pass, annual cash value increases become larger. As policyholders age, the cost of term insurance protection (which decreases the "investment" that offsets taxable increases in cash values) increases dramatically. The end result would be much greater tax liability during a policy's later years. Thus, the very purpose of "whole life" insurance -- viz., the employment of a level premium structure to keep life insurance affordable at older ages -- would be be undone by the imposition of a tax that would have the effect of making the policy more expensive every year.

Tax obligation imposed on a policy under the Reagan plan could indeed exceed the premium as the policyholder nears retirement age! For example, a $40,000 whole life policy, with a level annual premium of $535, issued to a 35-year old male, would generate taxable income of $1,098 at the policyholder's age 55.

By age 75, the same policy would generate taxable income of $1,644. In fact, industry actuaries have estimated that the average policyholder would pay some $5,800 in additional taxes over the policyholder's lifetime if the Reagan proposal to tax cash values were to be enacted.

Cash Values Hedge Against Social Security Overexpansion. Life insurance, both temporary and permanent, plays a most vital role in meeting the income security needs of people, and by doing so reduces the pressure on the Social Security system to provide ever higher and broader levels of benefits. Both permanent and term insurance provide benefits for survivors of breadwinners. Only permanent forms of insurance, however, provide survivor benefits at more advanced ages, as well as retirement benefits for breadwinners at retirement.

In view of the troubled financial state of Social Security during the last decade, this is not the time, in our judgment, to do anything to discourage people from acquiring permanent insurance. The decisions that might be made today which would have that effect won't show up as adverse results for many years. And the Congress knows only too well the difficulty of projecting the future financial position of Social Security, try as it might. If, as some Social Security experts suggest, long-range projections are off by only a small percentage, huge shortfalls in revenue may result.

Private funds may then be the only bulwark against future Social Security benefit increases. It would be catastrophic if tax policy-induced cutbacks in the retirement benefits of permanent insurance began showing up at the same time.

Cash Values Are A Source of Capital. Taxation of the increasing cash values of life insurance would also depress a proven source of needed investment capital. In 1984, life insurance companies provided more than $64 billion for investment in the economy of the country.

To walk through a life insurance company's investment department is to walk down the Main Street of most cities and towns in America. The telephone wires reflect investment in utilities; the shopping mall with its dozens or hundreds of jobs well might be financed at least in part by mortgages held by life insurance companies; housing construction is made possible through resources held by life companies. Life insurance company assets at work are reflected in corporate bond investments of well over $200 billion; mortgages of almost $150 billion; and corporate stocks in excess of $40 billion.

These primarily long-term investments are made possible because millions of policyholders are willing to commit themselves for long periods of time to cash value life insurance. According to the Life Insurance Fact Book of the American Council of Life Insurance, life insurance ranks in the top five among private domestic institutional sources of funds, supplying close to 8% of the total funds flowing into financial markets.

Taxation of funds attributable to policyholders would surely dilute this pool of capital to the extent that the tax would discourage the purchase of cash value insurance because, as compared with term insurance, substantially all of the investment capital derived from premiums comes from cash value life insurance premiums. The American Council of Life Insurance (ACLI) -- made up of 572 life insurance companies -- has said that, "Term insurance premium availability for investment is negligible." [ACLI Submission to the Secretary of the Treasury, W. Michael Blumenthal on a tentative Carter Administration Proposal to Tax Policyholders on the Interest Element of Life Insurance Contracts, Aug. 25, 1977, at p. 5]

If you don't think taxing cash values represents a real threat to capital formation, let me point to the experience of our neighbors to the north. Loss of the deferral of taxation on annuity investment yields -- which the Reagan plan also proposes to tax -- would probably decrease the use of annuities drastically. Certainly this occurred in Canada when, in 1982, the Canadian tax law was changed to allow tax-deferred annuity income buildup only to the extent annuities are "registered accounts" (roughly the same thing as our IRAs). Sales dropped by 50% from 1981 to 1982, and are still dropping. The full impact of the loss of this important retirement planning tool will be felt in years ahead as capital for investment is thus depleted and more and more inadequately-protected working people retire on insufficient retirement savings.

There Is No Constructive Receipt Of Cash Values. Under present law, amounts credited to the cash value of a life insurance contract are taxed only when withdrawn, and only to the extent the withdrawals exceed the aggregate premiums paid by the policyholder for the contract.

Thus, cash values are not current income. Rather, they are merely a measure of an accumulation that the policyholder may in fact never realize. Cash values are an accumulation that in most cases will remain only a beneficial interest. They are, in fact, part of the death benefit. Cash values become income only when all or part of the death benefit is foregone. It is a long-standing principle of tax law that income is not taxable until it is realized, either actually or constructively.

In the case of life insurance, the Tax Court held in Theodore H. Cohen, 39 T.C. 1055 (1963), that the taxpayer's right, prior to the maturity, surrender or sale of life insurance contracts, to receive the cash surrender value of those contracts, including periodic increments thereof, was subject to such 'substantial restrictions' as to make inapplicable the doctrine of constructive receipt. As you well know, this doctrine generally holds that income is taxable if there is no limitation or condition on the taxpayer's right to bring the income within his control, even if he does not actually do so. The court followed precedent to the effect that there is no constructive receipt of income -- hence no taxable income --

where one must surrender a valuable right in order to realize it. Tax liability on the interest earned on cash values would thus run counter to the doctrine of constructive receipt, creating the inequity, in countless cases -- most of them involving millions of middle class taxpayers -- of imposing a tax on money never to be received. Most people would say that is is bad enough to have to pay taxes to the Government on income; but it would be unconscionable to have to pay tax on money you never get!

As noted in one prominent 1972 study examining the current tax treatment of the so-called "inside buildup" (which, incidentally, conceded that this treatment can be justified on social, legal and administrative grounds), the bulk of the advantage of the present tax treatment accrues to middle income families. [McClure, _The Income Tax Treatment of Interest Earned on Savings in Life Insurance_, Joint Economic Committee Print, 92 Cong., 2d Sess., May 8, 1972, at 370]. It should not go unstated that the middle income wage earner presently bears an increasingly heavy share of the federal tax load and to impose additional taxes on a means of protecting his or her family against premature death would be unjust in the extreme from both a social and economic standpoint.

Analogous Purchases Are Not Taxed. On the question whether various types of permanent life insurance products should continue to enjoy historical tax-free treatment, your Committee might consider once more the analogy that we have alluded to in the past -- the analogy that exists between cash value life insurance, and say, a diamond engagement ring, or a home.

Each has a "savings" or "investment" element or aspect to it, which usually shows considerable enhancement in value. But does this mean that the "inside buildup" in the value of the diamond ring should be taxed? Should the growing equity in the home be taxed?

We think that your answer in those instances would and should be "No". We think so because in each case there is no receipt of the enhanced accumulation by the purchaser; and we think so because of the presumed motivation for the purchase. Even though the ring and the home both have a well-recognized growing "inside" value, neither item was bought for that purpose, or perhaps even with that in mind. The ring was bought for marriage, the home for shelter. Likewise, a life insurance policy is bought for protection and security.

In our opinion, Congress would have to weigh carefully whether it is reasonable and socially desirable to tax the appreciation in one of these kinds of property without logically taxing the others; or whether, instead, each serves a sufficiently worthy social and economic purpose that its historical tax treatment should be left unabridged.

Revenue Impact Is Negligible. Deletion of the proposal to tax the inside buildup would have almost no revenue impact.

According to Treasury Department figures, the proposal has no revenue effect at all until 1990, and then only $200 million. Even Secretary Baker has testified that this proposal is driven by policy and has little or no revenue considerations attached to it. To the extent that the purchase of cash value life insurance policies is discouraged, then even in the out years when the liability on the policyholder is highest, the revenue collected by the government is likely to be very low.

Conclusion. The historical and social justifications for the tax treatment of the cash value in a permanent insurance policy remain persuasive. To the extent that a permanent life insurance policy is purchased to provide long-term protection, and so long as it can be characterized as property whose investment features, if any, are merely a byproduct, it should continue to receive the tax treatment presently accorded it.

The taxation of life insurance cash values, like all other life insurance issues, was thoroughly and thoughtfully debated during the complete rewrite of life insurance tax law that took place over the last three years. The newly-enacted "definition of life insurance," found in §7702 which was added to the Internal Revenue Code July 19, 1984, represents consensus among the Congress, Administration and industry as the most appropriate mechanism to avoid investment-oriented abuse of life insurance policies. It is unfair, inefficient and foolish to reopen this question when the agreed-upon solution -- in effect for just 6½ months -- has not yet been tested.

We do not believe that this plan is truly a tax reform. Reform means to improve by change and this plan would not improve anything. It would, however, bring about change which we feel would not be in the best interest of the insuring public, particularly here in the state of Idaho. Finally, I would like to strongly urge you, Mr. Chairman, to vote nay on this portion of Mr. Reagan's tax reform package. Thank you for your time.

Senator **Symms**. Thank you very much. One thing you didn't say here—you said it's unfair, inefficient, and foolish to reopen this question after 6½ months with an agreed-upon solution. And I appreciate your testimony. It's a very comprehensive statement and the entire statement will be made a part of the record. And I thank you very much for it, Dick.

Now we want to hear from Dave Musko.

Go right ahead, Dave.

STATEMENT OF DAVID J. MUSKO, CPA

Mr. **Musko**. Thank you, Senator Symms and Congressman Craig.

What we have before you is a summary of tax reform and its impact on Idaho. The basic format is an article written in Management Accounting in March 1985 by a lot of big Ada County firms. It deals with tax reform and its impact.

What I have done, as we flip through a couple of pages, second to the end I have "Summary of." And it's a summary of the business tax effect on Idaho in relationship to other States.

There, we have a couple of favorable effects, unfavorable effects, and neutral effects.

In summary, the basic favorable effects would be into the areas of high technology and service.

The basic unfavorable effects, as you have heard today, deal in manufacturing, real estate, insurance industry and small business.

The last page, which is a small article from the Idaho Statesman, deals with how the—it's a summary of the personal tax effects on Idaho in relationship to other States. These have to do with your own personal taxes, and it deals with the personal exemptions and on the repeal of the Federal tax benefits for State and local taxes, and what other States are receiving and what Idaho is receiving.

If we maybe can briefly go through this, and I have little marks that have arrows going up and arrows going down, which I think are favorable and unfavorable for Idaho.

Basically I believe that the Tax Reform Act, when you look at things like ITC's and the slower depreciation rates, are unfavorable to smokestack industries, small business, commercial banks, and thrifts.

Keep in mind that the primary goal of the Treasury's plan is to create a system in which economic decisions are made independent of any tax consequence.

We also should keep in mind that the idea of the tax proposal is to be revenue neutral. That's where we see certain industry having a gain such as high technology and service areas, that we see certain areas having a detriment, which is basically manufacturing.

We also see a shift from the tax burden going to business which is manufacturing, for example, and away from the personal sector. And that's why you have an increase in personal exemptions and a reduction in the State and local taxes.

I'd like to talk about the first page in that, overall, the tax reduction from a corporate rate of a high of 50 percent to 30 percent is favorable, but in relationship to other States, it probably has a neutral effect.

The same with the investment tax credits. It would probably have a neutral effect in relationship to other States. In other words, all manufacturing industries would be hurt regardless of the State that they're in.

I'd also like to touch on another primary goal of the Tax Reform Act, and that is for fairness, simplicity, and economic growth. They're all good terms; everybody likes them.

But when we take a look at certain things, like going away from the ACRS, which may be cumbersome to some, and go into this real cost recovery system that deals with inflation factors and being spread over 40 years, I would consider both of them would be that—that the real cost recovery system is more cumbersome than the ACRS.

Also, with the index of interest and so forth, I would consider that most people would consider that more cumbersome than less cumbersome.

And we deal with some accounting methods that are changing. That's on the next page in this article. And that deals with indexing FIFO, which is first in, first out. That would probably be considered more cumbersome than less cumbersome.

Going on to the next page, this summarizes things about what would be the effect, and it would be an adverse effect in general, to capital-intensive industries and expanding companies basically through, as I mentioned earlier, ITC's and slower depreciation write-offs.

In the next column, the people that would have benefits would be service- and people-oriented areas. And Idaho's tax effect in relationship to other businesses would be probably neutral.

The same with manufacturing and capital-intensive industries. In relationship to other States, the effect would probably be about neutral.

Regulated industries would go up also because they're considered capital-intensive. High-technology, labor-intensive industries go up.

The oil industries, their taxes would go up. But since Idaho has no oil industries that they're drilling for oil, Idaho's benefit would probably be higher in relationship to other States, particularly Texas and Louisiana.

The next page deals with another summary, and it deals with lower corporate tax rates which I think are positive. It deals with some other dividend distributions, and I think that it's a fair statement to say that maybe we should have a reduction in double taxation of retained earnings and dividends.

And then we have some other things that deal with matching of expenses and receipts. And I think that's favorable.

There is also going to be a reduction in tax credits that relate to research and development, which could be considered unfavorable when we look at industries like Micron, which is a high-technology industry.

And even other industries, if we want to get into mining and lumber, are indeed basically, I think, something that the United States is very fond of and very proud of. And a lot of it has to do with the stimulation of the tax proposals which now are in jeopardy.

Going over a couple more pages basically raises the question of simplification. Ernst & Whinney thinks that when you look at things like depreciation and the indexing of interest and other items, that the question arises: Is that more simple or is it less simple?

Now, this is where Idaho probably has it worse than other States. In general, this deals with small business. With the industry the way it is in Idaho, small business has the biggest growth. So what we want to do is encourage small business.

Two-thirds of the way down there we see that 82 percent of new jobs a year are created by small business. Small business is the growth business.

And what we see there, we have a flat tax rate of 33 percent. It may help the corporations and the big corporations; it would be a detriment to small business because the first $25,000, for example, has a much smaller tax rate than 33 percent.

I also get into some things like ITC's and the need for capital to start businesses.

So probably—Idaho would probably have more growth in small businesses related to other States, in which case the small business proposals would be unfavorable to Idaho in comparison to other States.

We have a couple more pages, and then we're back to the second to the last page, which is a summary.

Just recapping briefly, the summary of business-tax effect in Idaho in relationship to other States, that in the high-technology and service area, it would be favorable to Idaho. However, it would be unfavorable for small business, manufacturing, real estate, and insurance industries.

How those two would get together and what is the future of Idaho and what the proposal is, I won't speculate on.

Then on the last page when you look at the business which we've talked of primarily, we also see a shift of business taxes going up, but personal taxes going down. And that basically relates to the personal exemptions.

Also, I think that Idaho is in a good position to favor the tax reform position of President Reagan that deals with the disallowance of the tax benefits of State and local taxes.

There are some people that argue that because Idaho has a smaller savings per capital, that we are actually subsidizing States that have larger State tax payments, such as New York and California.

Thank you for your attention.

[The articles, together with summaries, referred to by Mr. Musko follow:]

Tax Reform and Its IMPACT

THIS WILL BE THE YEAR OF SWEEPING TAX reform if President Reagan has his way.

Following weeks of distancing himself from the Treasury Department's controversial, three-volume report on "Tax Reform for Fairness, Simplicity and Economic Growth," the President has reiterated that tax simplification will be one of the most important domestic issues of his second term.

This presidential initiative has generated widespread concern among business and investment groups that would be most affected if legislation is enacted based on the Treasury's proposals. For example, real estate, the smokestack industries, small business, and commercial banks and thrifts may be among the "losers" if the Treasury's proposals to revamp the tax system become law.

What do these proposals mean to business in terms of tax planning? What can controllers and management accountants do now to cushion the impact if Treasury's reform proposals become law? MANAGEMENT ACCOUNTING editors talked to a number of experts from accounting firms, industry, and industry groups. We asked a series of questions regarding the probable impact of tax planning. Here is what we learned, including a summary of the major proposed business tax changes.

'Don't Panic Yet'

Tax experts advise don't panic if your company falls into the "loser" category. Not only do these experts expect the proposal to undergo many modifications, but they emphasize that if passed the changes would not become effective until January 1986. This means there would be several months in which to react if the Treasury's blueprint for tax reform becomes law. Also there are two sacred and long-standing rules that should calm corporate tax planners. First, new tax laws are rarely applied retroactively—usually they become effective from the date of enactment forward. Second, grandfather rules may soften the harsh and unexpected impacts of new laws on commitments made under the old rule.

The primary goal of the Treasury's plan is to create a system in which economic decisions are made independent of any tax consequences, in effect, one characterized by tax neutrality: a corporation would not be compelled to make investment decisions based solely on tax reasons. Similarly, one industry should not be preferred tax-wise over any other. To achieve this goal, the Treasury Department proposes a more comprehensive definition of income subject to tax than currently exists and the elimination of certain preferential deductions and credits.

Other goals of the Treasury's proposals include a tax system perceived as fair, the balanced treatment of corporate and individual taxpayers, encouragement of economic growth, a flexible tax system that adjusts appropriately for inflation, and a fair and orderly transition from the current system to any new system.

The Treasury plan envisions a substantial modification of the current system. It would lower corporate taxes to a single rate of 33% and allow a deduction of 50% of dividends-paid. But what it gives with one hand the Treasury takes away with the other. It proposes repeal of current popular investment and other tax credits.

The investment tax credit (ITC) would be eliminated. As a substitute for the present Accelerated Cost Recovery System (ACRS), the Real Cost Recovery System has been proposed. Under the RCRS, assets would be categorized among seven depreciation classes instead of the current five. Each year the remaining unrecovered basis of an asset would be increased by the inflation rate, and a constant depreciation rate for the asset's class would be applied against the resulting depreciated cost. The Treasury believes RCRS would increase productivity, give proper allowance for inflation, eliminate the "front loading" of deductions that encourage tax shelters, and make lower tax rates possible through a broader tax base.

The Treasury also proposes indexing of interest income and expense for inflation in order to further remove inflation as an influence on the tax system. This measure is expected to lower taxes or at least alleviate the effect of higher tax rates.

New tax accounting methods also would be introduced. The use of the cash accounting method would be restricted to businesses that do not use the accrual method for financial accounting purposes, carry no inventories, and have gross receipts of less than $5 million. Bad debt deductions would be limited to actual loan losses and no longer would the installment sales treatment be allowed for pledged receivables.

Businesses also would be able to use a new indexed first-in, first-out (FIFO) method of accounting. This "indexed FIFO" method would adjust the cost of goods for inflation occurring after the goods were acquired. Coopers & Lybrand has observed that this provision might be more beneficial in inflationary periods than last-in, first-out (LIFO) accounting. Under indexed FIFO, it is intended that gains in inventory values arising from inflation would never be taxed. By contrast, under LIFO, the tax on inflationary gains is merely deferred until the inventory is liquidated.

According to the Treasury report, the current LIFO conformity requirement results in a "schizophrenic" treatment of inventories and should be repealed. Under current law, a company using LIFO for tax purposes must use the same accounting method for financial reporting purposes. This provision has discouraged companies from adopting LIFO, because many firms believe the use of LIFO for financial reports puts the company at a competitive disadvantage in attracting investment funds relative to firms that report profits using FIFO accounting.

The effect of the proposal will be adverse across the board, but it will be especially hard on the real estate industry.

Robert D. Milburn

The proposal relating to international business transactions retains the basic system of taxing international transactions, but makes a significant change in calculating the foreign tax credit (FTC) and eliminates some provisions that are viewed by the Treasury as providing undue preferences.

The limitation on allowable FTCs would be computed based on the income from, and taxes paid to, each separate country (a "per country" limitation). This would restrict the current ability to use FTCs attributable to income from high-tax rate countries against the U.S. income earned in low-rate countries.

Several rules that determine the source of income (foreign or U.S.) would be modified. For example, the current rule that sales income is sourced at the location where title passes would be changed to source income at the seller's residence. The rules for allocating expenses to foreign-source income under regulation 1.861-8 also would be revised so that interest expense would be allocated on a combined-group basis rather than on a separate-company basis.

Certain subsidies for specific industries are targeted for repeal. The energy industry would have to contend with the elimination of both percentage depletion and the expensing of intangible drilling costs (although each is partially offset by an accelerated repeal of the windfall profits tax). Commercial banks and thrift institutions would lose their special bad debt deductions, and would not be able to deduct interest incurred to carry tax-exempt bonds. Some high-tech firms could suffer from a more restrictive definition for R&D credit qualifications.

Business Leaders Wary of Plan

As MANAGEMENT ACCOUNTING went to press, business executives were reluctant to comment on the Treasury's proposals. They noted that the proposals almost certainly would be revised and the final package may have little resemblance to the original proposals. The National Association of Manufacturers released an economic analysis, based on the data of the Wharton Econometric Forecasting Associates Annual Model of the U.S. Economy, and concluded that "The effects of the Treasury proposals on the long-term trajectory of the economy are ambivalent at best and at worst highly unfavorable."

Jerry Jasinowski, NAM's executive vice president and chief economist, said: "There will be a significant increase in consumer spending in the short run, a rise in wages, and somewhat greater employment. These will come about as a result of a shift in the mix of economic activity toward personal consumption and away from capital formation."

Some of the major conclusions of the NAM analysis:

- The proposals reduce investment spending in virtually all categories. The user cost of capital is raised, while the after-tax rate of return on investment and real after-tax profits are lowered.
- The mix of economic activity is progressively weighted toward personal consumption and away from capital formation.
- Because of lower productivity and higher em-

ployment, unit labor costs rise more rapidly under the Treasury plan, resulting in a modestly higher rate of inflation.

- The distribution of tax liabilities is shifted toward business and away from individuals.

The NAM is emphatic on a crucial point: "The plan is not revenue neutral; it raises more revenue than the present system, mainly from the corporate side."

CPAs React to Tax Reform

Public accounting firms have been quoted extensively on the Treasury's proposals. Here's what they told MANAGEMENT ACCOUNTING.

What effect will the proposal have on the economy and business?

Ernst & Whinney: Ted Reiner, manager and director, Client Tax Communications; Robert Black, manager and visiting professor from the University of Texas; and Ken Orbach, manager and visiting professor from Louisiana State University:

The proposal is beneficial to the economy in the long run because the current system twists and distorts investment decisions. Under the proposed plan, decisions are not driven by what the tax consequences may be. It would create an economy where business and investment decisions are not concerned with tax angles.

The types of clients that we believe will be most affected include capital-intensive industries and expanding companies because of the loss of the ITC and slower depreciation write-off. The plan is especially tough on small business and start-up companies.

E&W has been on record: We think there should be a moratorium on tax law changes. In 11 years there have been 10 changes in the tax code. Business has not been able to digest what has happened to the tax code. We believe a national commission should be formed—similar to the Grace Commission that was formed to see what could be done about wasteful spending—to review tax law with a view to simplifying and reforming it.

The Treasury plan has good theoretical concepts but we don't know how all the pieces will fall. We believe the Treasury's plan for simplification is an excellent, well thought-out document. Now we recommend that a commission be formed using the Treasury's plan as a basis to do a review of the U.S. tax system.

Byrle M. Abbin, managing director, office of Federal Tax Services, Arthur Andersen & Co.:

The proposal encompasses a lot of broad proposals with a tremendous dearth of detail. It is our observation that the more expert you are in a particular area of taxation, the less you can understand where the proposal is coming from or where it is going. The technicians have a hard time with it and see more problems than solutions.

The proposal will have a mixed effect on the economy if it is enacted as it now stands. In general, it seems to serve the areas of the economy that are service- and people-oriented. For example, the retail industry. On the flip side, a much more onerous situation is created for basic manufacturing and capital-intensive industries as well as the regulated industries. Although the large basic industries will be hurt, small and medium-sized manufacturers will tend to be better off even if they have to give up investment tax credits and depreciation write-offs. High-tech industries will be preferred because they are labor intensive.

The more expert you are in a particular area of taxation, the less you can understand where the proposal is coming from or where it is going.

Byrle M. Abbin

Therefore, in the manufacturing sector you have a trichotomy: old industry that desperately wants to keep the investment tax credit and other incentives, in contrast to the high-tech companies, and small and medium-sized manufacturers which are willing to trade off these incentives if they could be assured of a lower tax rate.

In the financial sector, banks with tremendous bad debt reserves would suffer because of the loss of the bad debt deduction. Also, banks would not be able to deduct interest incurred to carry tax exempt bonds. Life insurance companies would be affected because if current law is changed and investment income earned on life insurance policies is taxed, their main product would not nearly have the market appeal that it has now.

The merchandising sector would be benefited significantly because the higher taxes now paid by these companies would be lowered under the Treasury's plan.

Principal Treasury Tax Proposals Affecting Business

Major proposed changes	Effective dates and transition rules	
Basic taxation of capital and business income		
A. Lower corporate tax rates		
1. Single corporate tax rate of 33%.	7-1-86	for corporations formed after date legislation is introduced; all corporations by 1-1-87
2. Repeal corporate minimum tax.	1-1-90	
B. Capital gains and adjustments for inflation		
1. Gains on sales of assets: index basis (cost) of assets, repeal preferential treatment of capital gains, and tax real gains as ordinary income.	1-1-86 1-1-89	for all assets purchased after 1-1-86; for assets purchased prior to 1-1-86, capital gain effective rate not greater than 20% until 1-1-89 when indexing begins
2. Index depreciation for inflation and set depreciation allowances to approximate economic depreciation.	1-1-86	for assets purchased after 1-1-86; permanent grandfathering for assets purchased prior to 1-1-86
3. Allow indexed FIFO and repeal LIFO conformity requirement.	1-1-86	
4. Index business interest payments and receipts.	1-1-88	
5. Index nonbusiness interest receipts and payments (other than principal residence mortgage interest plus $5,000).	1-1-88	
C. Dividend distributions		
1. Reduce double taxation of distributed corporate earnings by allowing 50% of dividend paid deduction.	1-1-87	phase-in over 6 years
2. Allow a 50% (rather than 85%) dividends-received deduction for intercorporate dividends for portfolio investments.	1-1-87	phase-in over 6 years
D. Accounting changes		
1. Match expenses and receipts from multiperiod production.	1-1-86[1]	
2. Restrict use of cash accounting method.	1-1-86	with income increase due to change spread evenly over 6 years
3. Limit bad debt deductions to actual loan losses.	1-1-86	with income increase due to change spread evenly over 10 years
4. Disallow installment sales treatment when receivables are pledged.	1-1-86	for new pledges, pledges existing prior to 1-1-86 subject to new rules 1-1-91
E. Tax credit revisions		
1. Repeal investment tax credit.	1-1-86	
2. Repeal rehabilitation tax credits.	1-1-86	for expenditures incurred after 1-1-86 unless incurred pursuant to a binding commitment entered into prior to that date
3. Revise credit for research and experimentation.	1-1-86	for all research and experimentation after date legislation is introduced

Lorin Luchs, tax manager in the national tax office of Seidman & Seidman:

The Treasury's goal to achieve tax neutrality is admirable but one that is entirely new to our scheme of taxation. My concern is that it will be a big adjustment for business and the economy. In the past, tax laws have been used by the government purposely to influence economic decisions. For example, the Economic Recovery Tax Act (ERTA) was passed to provide incentives for economic growth. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) was introduced

Princip[illegible]ury Tax Proposals Affecting Business

Major proposed cha[illegible]	Effective dates and transition rules
Investments	
A. Municipal bonds	
1. Repeal the tax exemption of private purpose bonds.	1-1-86 for bonds issued after 1-1-86, but allow refinancing of existing obligations with no extension of maturity
2. Tighten restrictions on tax arbitrage and advance refunding for tax-exempt bonds.	1-1-86 for bonds issued after 1-1-86, including refundings
B. Insurance investment income	
1. Repeal exclusion of investment income on life insurance policies.	1-1-86 for income earned after 1-1-86
2. Treat policyholder loans as coming first from any tax-exempt inside buildup.	1-1-86 for loans made after 1-1-86, loans existing prior to 1-1-86 would be subject to new rules 1-1-91
3. Repeal exclusion of current annuity income.	1-1-86 for income earned after 1-1-86
C. Tax-favored investments	
1. Disallow most current nonbusiness interest deductions (with carry-forward) in excess of the sum of mortgage interest on the taxpayer's principal residence, investment income, and $5,000.	1-1-86 Phase-in—use new netting rules with existing $10,000 limit for 2 years; drop limit to $5,000 beginning 1-1-88
2. Extend at-risk limitations to real estate and equipment leasing.	1-1-86 for sales and leases after date legislation is introduced; permanent grandfathering for sales and leases prior to date legislation is introduced
3. Require that all partnerships with more than 35 limited partners be taxed as corporations.	1-1-86 for partnerships formed after date legislation is introduced; 1-1-90 for partnerships organized before the legislation is introduced
International issues	
1. Change foreign tax credit limitation to a separate per country limitation.	1-1-86 excess foreign tax credits accumulated prior to 1-1-86 carried forward up to 5 years; losses occurring prior to 1-1-86 recaptured until exhausted
2. Modify rules defining source of income derived from sales of inventory-type property and intangible property.	1-1-86 for all sales after date legislation is introduced; permanent grandfathering for sales contracted prior to date legislation is introduced
3. Repeal the secondary dividend rule and replace with a branch profits tax.	1-1-86

[1] Applies to costs incurred on long-term contracts and self-constructed assets after 1-1-86, with a 10-year phase-in for existing timber and a 6-year spread on any income from an inventory change.

Source: Ernst & Whinney

to reduce the deficit. The Treasury's proposal for reform and simplicity is determined to take our tax system in the opposite direction—to create a tax system that does not try to influence economic decisions.

Although I think tax neutrality is a good idea, my concern is that if the plan is passed in its present form and certain industries lose investment incentives, a neutral tax system may not work. I am thinking specifically about the real estate and housing industries. If, for example, the investment incentives such as fast depreciation write-offs are lost and rental housing declines, the government may be pressured into providing subsidies to encourage growth and influence investment decisions. Tax neutrality would be lost, and once

again the government would be using tax law to influence our economic decisions.

Can the proposal accomplish simplification?

E&W: It goes both ways—while it eliminates current complex computations such as the ITC, many provisions in the proposals—for example the indexing provision—add additional complexity to the system. Many of these proposals are being sold as tax simplification, but many of the new rules and new transition rules are complicated.

Over the last 25 years, attempts that were made on the part of the government to close loopholes have resulted in complicating the tax code, not simplifying it. A recent example is ACRS, which has been amended several times. It is now twice as long as the original law that was enacted four years ago. It's the nature of the beast that the tax code be complex.

Byrle Abbin: The indexation of interest is extremely complicated. It especially complicates the front end of the investment decision because you are in effect making a Las Vegas-type bet on whether interest rates will go up or down. If you make the wrong bet you will find that your cost of capital is greater than anticipated and therefore your business decision is very onerous. On the other hand, the lender will get a windfall. What most people must realize is that the businessman can cope with most things better than uncertainty, and indexation of interest is the biggest uncertainty of all.

John L. Withers of Touche Ross & Co.: There are fresh complexities that arise from the Treasury's attempt to expand the extent to which nominal income is indexed for inflation. Under the present system, to prevent bracket creep, limited specific items (tax brackets, zero bracket amount, and personal exemptions) are adjusted for inflation, beginning this year. But the simple concept of adjusting specific items for inflation is carried much further in the Treasury proposal.

Interest income, interest expense, the basis of assets for gain determination, FIFO inventory, and the unrecovered basis of depreciable property would all be indexed.

What recommendations are you making to your clients in regard to this proposal?

E&W: There is typical uncertainty among our clients, but we are not anticipating passage of the proposal in its present form. Some people are operating as if it has been passed. Rather than advising clients to take action because certain provisions will be passed, we are spending more time clarifying what the proposals are and the effective dates that if passed would have an effect on business. It is difficult to know what will happen. It is "a very iffy" situation and you can't hide with your tail between your legs. It is much better to explain the effective dates than to spend time preparing clients to cope with proposals that may never be passed.

What parts would you like to see modified?

E&W: For the individual, we are concerned with changes in employer-paid medical insurance and employer-paid group term life insurance and employer-paid death benefits. Under present law, the monthly premium is tax-free to employees. This would change. Effective January 1, 1987, the monthly premium would be taxed to employees to the extent it exceeds $70 for employee-only coverage and $175 for family coverage. Currently, premiums for group term life insurance up to $50,000 are generally tax-free to employees and employer-paid death benefits up to $5,000 are tax-free to employees' beneficiaries.

There will be huge social costs if these provisions are passed. The reason Treasury introduced these changes is because fringe benefits have gotten out of hand and the number of excluded items has increased. But now the pendulum has swung the opposite way. We see this as a drastic move away from favorable health and welfare benefits that benefit a large segment of the population. It is shortsighted.

The change involving the bad debt expense that limits bad debt deductions to actual loan losses should not be included. The Treasury plan tries to match costs with associated revenues. The proposal is contrary to that goal. The plan goes against generally accepted accounting principles.

What the Treasury is saying is we want you to measure income on the accrual method of accounting but we want to give you only the deductions on the loss you experienced. We also would modify rules governing capital losses—they should be deductible in full. The Treasury plan puts a cap on capital losses.

Small Business Is Angry -

What about the impact on small business?

Small businesses, to put it mildly, are stunned by the Treasury Department's plan. A flat corporate tax of 33% will mean a tax increase for many. They feel they will bear the brunt of the reform if the proposal passes.

Lewis Shattuck, executive vice president of the Smaller Business Assn. of New England, says the burden on small businesses will increase. "For example, businesses in the $0-$25,000 bracket—their current tax of $3,750 would be raised to $8,333, a 112% increase. The tax of those at the $25,000-$50,000 level would increase from $4,500 to $8,000, an 85% increase. We don't like that at all!

"We also don't like the significant increase in capital gains tax. Previously small businesses had achieved significant victories in the drop in the capital gains rate, especially since 1978. If the rate goes up again, it will cause available capital to flee, and small businesses that are starting up will be hurt. In 1983, after the maximum capital gains tax was reduced to 20%, $4.1 billion in new venture capital was available for young and growing businesses, over 50 times the amount in the 1970s with a 49% rate. Entrepreneurs could get money to grow. If it kicks up again, small businesses are in trouble. You'd think that since 82% of new jobs a year are created by small businesses, the government would take them into consideration. This is like kicking the goose that laid the golden egg!"

Another area cited is corporate dividends. "Because most small businesses don't pay dividends, they won't be helped," he added, suggesting that the government's big business friends would benefit well from the 50% allowable deduction.

Joseph Mancuso, head of the Center for Entrepreneurial Management, agreed. "It sure doesn't look as though this bill is being done for small businesses. It seem as though they are last on the totem pole. Their programs weren't even taken into consideration!

"Some of the carrots that small businesses have been asking for over the years, such as rollover in capital gains, aren't even included—the *little* pieces aren't there. It seems to be an affront to small businesses."

Ron LaMange, treasurer of Clipper Belt Lacer Co., a small manufacturer in the Midwest, notes that the most significant problems will derive from the loss of research and development credit and the investment tax credit. "It will push up the cost of doing business," he says. "Most small businesses now pay less than a 33% tax—it's usually around 25%-27%, so their taxes will be higher. Plus they usually are family owned or have just two or three owners and they don't pay dividends, so they will have no credit there. It probably will cost us an extra 10%-15% if the plan is phased in immediately."

He cites small manufacturers in particular as being affected by the loss of R&D and ITC, "especially now when they are making so many technological advances to improve job performance, such as robotics. Many small businesses won't even be able to justify new equipment. Businesses that are capital intensive will be hardest hit, more so than service industries, for example.

"The flat tax also will strain the economy in general, especially as small businesses feel its effects. The rate now is only 27% on a company's

first $100,000, but that will increase. For a large corporation, however, the flat tax will be a godsend. We can only hope that there will be enough big companies benefiting to offset the losses felt by the smaller businesses. It seems as though the proposal is a step backward.

"It's also hard to believe the move away from favorable depreciation. Many small businesses will be penalized. The government always seems to try to make it a zero sum game—some win and some lose—so we'll just have to see what happens."

CPAs also expressed concern about the impact on small business. Here are some comments.

E&W: We are genuinely concerned about how the proposal will affect small business and start-up-companies. In most cases, the tax burden falls fairly but with small business there is an exception. We hope for some changes in this area. How can small business cope? We may see more income splitting and gifts to members of family. Companies may start pension plans to try to reduce taxable income. Companies will use more debt as a device to shelter income.

The Treasury plan has good theoretical concepts but we don't know how all the pieces will fall.

Ted Renner

Byrle Abbin: In the past, small business has been a favored industry. However, there is now an ironic attitude in Washington that continuation of family-owned corporations results in the biggest use of tax shelters of all. I can't understand that line of reasoning.

If the Treasury plan is enacted, small business would be severely affected, especially the "mom and pop" operations because the plan does away with the graduated tax rate. For many small businesses that could increase taxes a third or more.

Lorin Lucks: If small business needs the income to plow back into the business, than the higher 33% tax rate is a hardship. To help small business, Seidman & Seidman has proposed a "small business consumed income tax" to provide small corporations with 10 tax-free years. To qualify, a company would need sales of less than $20 million, assets of $5 million or less, and income of less than $1 million. A qualifying corporation could have only one class of stock and 35 or fewer shareholders. Once it qualified, a company would receive a 10-year exemption from all federal income taxes on earnings if reinvested in the corporation. But investors would be taxed—at higher individual income tax rates on all nonbusiness expenses incurred by the corporation and any dividends paid out to shareholders. At the end of the 10 years, the company would become either a "Subchapter S" or a regular corporation and it would then be taxed at normal corporate income tax rates. The proposal is now up for debate. With the huge deficit taking priority we may not be able to get it passed this year, but we believe in the long run it has a good chance of being enacted.

What impact will the proposals have on the real estate field?

Byrle Abbin: The real estate industry would probably feel the effects of the proposal immediately. If the plan goes through, I think you will see a tremendous decrease in commercial buildings and rental property. Rents might be increased to compensate for the reduced cash flow from tax benefits available under current law. People in real estate will tell you that rents are lower today as a result of tax incentives.

Also real estate investments have often relied heavily on debt-financed acquisitions. When interest indexation is combined with reduced cost recovery deductions, it is clear that substantial debt financing of real estate, say 90%, would be a questionable investment structure.

Robert D. Milburn of Laventhol & Horwath: The effect of the proposal will be adverse across the board but it will be especially hard on the real estate industry. My expectation is that the provisions relating to real estate will not go through. At this time I am not advising my clients to make any specific investment decisions in anticipation of passage of the proposal because I can't conceive of Congress accepting such an unfair result.

The proposal is intellectually dishonest because it purports to shut down tax shelters of the wealthy and thereby make the system fairer. Under the proposal, partnerships with more than 35 limited partners would be taxed as corporations. This effectively freezes out the middle class taxpayer from investing in the market, and does not affect the wealthy investor at all.

▶▶ 62

Tax Reform

28◄◄

The proposal is also unfair to consumers of rental housing. In the future, for the renter to receive the same grade of housing he would probably have to pay more in rent to replace the tax benefit return on the investment which the investor no longer receives.

The Treasury Wish List

At this time it's pointless to speculate about the future of tax reform and simplification. Tax theorists, politicians, and special interest groups are presenting persuasive arguments against various aspects of the proposal, and Congress is almost certainly going to make many modifications in the course of deliberations this year. But whatever the outcome, prudence demands that management accountants and corporate tax planners review the key areas targeted for change before near- and long-term tax strategies are formulated. As Ted Reiner of Ernst & Whinney's Washington tax office said, "the Treasury wish list is likely to become Congress' shopping list." ☐

Contributors: Kathy Williams and Robert F. Randall.

Summary of Business tax climate on IDAHO in relation to other states

	Favorable		unFavorable	neutral
	↑		↓	—
	↑		↓	—
	↑		↓	—
	↑		↓	—
High	↑	small	↓	—
tech	↑	business	↓	—
+	↑	–	↓	—
service	↑	manufacturing	↓	—
	↑		↓	—
			↓	
	9		10	9

Boise, Idaho [illegible] Tuesday, August [illegible] 198

Copyright© 1985 The Idaho Statesman

The Idaho Statesman

122nd year, 13th issue

A Gannett newspaper

U.S. total:
$28.48 million

Average per capita:
$120

Advisory Council on Intergovernmental Relations

Ann LaRose/Statesman

Summary of personal tax effect on IDAHO in relation to other States'

	Favorable	unfavorable	neutral
See above	↑		
personal exemption from $1000 to 2000	↑		
	2	0	0

BEST COPY AVAILABLE

Senator Symms. Thank you very much, Mr. Musko. We appreciate all of your testimony very much.

Did you make any analysis of how it would affect the food processing industry?

Mr. Musko. Food processing would probably be considered manufacturing, so that would be a detriment. Manufacturing is hurt in this proposal.

However, if manufacturing is going to be used more, labor-intensive—and there are some manufacturing plants that are more labor intensive, and that would be a positive effect.

Senator Symms. Frozen potatoes is what I was thinking about, that type of industry that provides a lot of jobs.

Mr. Musko. That's right. In which case it would be labor intensive, and then positive.

Basically, what we want to take a look at is the mix of manufacturing versus labor.

Senator Symms. Larry, do you have any questions?

Representative Craig. No; just to thank all that are here. The testimony is really very excellent and well detailed. I want to spend some time reading through it.

I do have one question of John. You made a statement toward the latter part of your testimony, and I'm not sure the basis that you got your figures from. And if you said it earlier, I apologize because I did not come in until you were into your testimony.

You said using the loss in value figure mentioned earlier, $298 million for all residential properties, local taxing districts would lose $3,046,000, and then you go on down to talk about the hypothetical 500 housing unit community mentioned above, the tax loss would be $296,000.

What's your basis for making that projection on Idaho revenue?

Mr. Browning. Projecting the revenue, the loss, would be based upon loss of value of property and taking and analyzing that in relationship——

Representative Craig. New properties?

Mr. Browning. Existing property; existing property value. If the tax proposal went into effect as it's proposed, that's what we're projecting, would be the loss of value. And where we're on a market value basis for property taxation, that's how much decrease in revenues that we would project.

Representative Craig. OK. Thank you. That had escaped me.

Senator Symms. Thank you, Larry.

Dave, on your summary back there where you've got 9 points favorable, 10 points unfavorable, 9 points neutral, then I take it that, as an accountant, you'd say that there is an awful lot—if this bill was passed without major limits, that there is an awful lot of stirring up the pot going on here for very little benefit to anybody.

Mr. Musko. That's true. As a whole, there is no benefit to the economy, as a whole. It's supposed to be tax neutral.

Senator Symms. So then you come back and say we ought to cut spending. Is that what you're saying?

Mr. Musko. That's true. I like cutting spending. I think that's one of your proposals also. I'm in favor of that.

Senator Symms. I mean, do you think that's more important than this tax proposal?

Mr. Musko. Yes, I do.

Senator Symms. Richard?

Mr. Cooke. Yes; I have to agree with that.

Mr. Nelson. Yes; I definitely agree with that.

Senator Symms. You already said it in your testimony.

Mr. Browning. Yes.

Senator Symms. But you all agree that we should be cutting the budget spending. See, there's an awful lot of rhetoric about reducing the deficit in Washington, and I would just only caution everybody that if they get trapped in using the rhetoric, it may mean that they're talking about raising taxes. It doesn't reduce anything if we continue to spend as much money as we're spending. We can either tax for it, print it, or borrow it. We still take the money away from the private sector, bleeding it off into the nonproductive enterprises that the Government involves itself in, in many cases. So it's a very important distinction, I think.

I think that Rip had a question about tax rates.

Mr. Ripley. I just wanted to clarify one thing with Dave's testimony.

Did I understand that your testimony was that it would be unfavorable to small businesses because the corporate rates would be higher than they are now?

Mr. Musko. That's true, for the—first, because we want a progressive tax system, that your first $25,000 is taxed at a lower rate than what the flat rate would be.

Senator Symms. Now——

Mr. Ripley. I want to clarify that. Under the proposal, the first $25,000 would still be taxed at 15 percent.

Mr. Musko. I'm glad to hear that.

Mr. Ripley. The second $25,000 at 18 percent, the third $25,000 at 25 percent, so, you know, that which is less. It's currently $30,000.

Mr. Musko. I appreciate that. Thank you.

Senator Symms. Seeing no further questions, thank you all very much for your testimony. We appreciate it. All of your entire statements are part of our record, and I thank you very much for your very excellent contributions to this hearing record.

[Whereupon, the panel members were excused.]

Senator Symms. I think that the Chair at this point will take a 5-minute recess, and then we'll commence back at 11:30 with Mr. Alan Cameron of the Idaho Credit Union League; Martin Hurbi, Idaho Bank & Trust; and the Honorable Tom Stivers, speaker of the house, State of Idaho. And they will be our next panel. So they can be up close to the witness table.

[Whereupon, a recess was taken.]

[Whereupon, the panel members assembled.]

Senator Symms. OK. The subcommittee will be resumed back on the hearing where we were. And despite the efforts that I had, the good intentions I had, to move faster, I see we're just about on the timeframe. But I will ask the witnesses—one thing I don't want to do is have anybody testify here and not feel like they got to make their points. So we want everybody to feel comfortable, to make the points you want to make to the committee.

Your entire statements will be made a part of the record and will be printed in the record as though stated, but I do want you to try to keep your testimony as much as possible within the 5- to 7-minute range. We haven't, as you know, stuck firm to that, as you have seen this morning, because I don't like to deny people the opportunity to testify before the congressional committee. I think it's a part of our system. It's a very important part that the public gives input to those of us who represent the State in the National Congress.

I will now commence with—and I want to thank all the witnesses that have made some of this fine testimony, because it has been very excellent. And I can see that there is a lot of work that's gone into it.

Mr. Alan Cameron from the Idaho Credit Union League will be the next witness.

STATEMENT OF ALAN D. CAMERON, ATTORNEY, ON BEHALF OF THE IDAHO CREDIT UNION LEAGUE

Mr. CAMERON. Senator Symms, Congressman Craig, I'm pleased to be here today to present the views of the Idaho Credit Union League on the matter of credit union taxation. I have submitted to your staff a copy of my prepared testimony. I will not read that verbatim, but will jump around a bit in that testimony.

The Idaho Credit Union League is an association of credit unions doing business in the State of Idaho. Through its 112 member credit unions, the Idaho Credit Union League represents approximately 202,000 members in the State of Idaho.

I come here today in hopes that I may briefly demonstrate for you the present nature of the credit union financial system and its very people-oriented 51-year history. At the same time, I hope also to convince you that reversing present credit union tax policy would forever remove the nonprofit consumer orientation which presently provides the focal point of the credit union movement.

In doing so, I am representing the interests of all Idahoans who are credit union members, because there is no doubt that they would be hurt by a change in the present credit union tax policy.

While the taxation of credit unions would affect each of its members, the brunt of taxation would likely be borne by the marginal segment of the credit union population. In contrast, the more affluent members of each credit union would probably be "inconvenienced" by taxation, but would not be dramatically hurt.

Each credit union, though, has its younger members just starting out, or the elderly on fixed incomes, or a group with an economic disruption such as a strike or plant closing. It is these people who will feel acutely the loss of the credit union's ability to provide them with free financial counseling, free transportation to the credit union for elderly members, free life savings and credit disability insurance, and on and on.

Additionally, the spectre of taxation may require some credit unions to take a more aggressive stance against those members who have found themselves in financial difficulty and are unable to repay their loans. Credit unions are well known for working with their members during trying financial times but, as I think you'll see, the effect of credit union taxation would likely be to make economically impossible for credit unions to do so in the future.

Senator, I know you are aware of the recent developments concerning the Potlatch Corp. in the Lewiston area. Potlatch Co. employees are served by at least four credit unions ranging from the 538-member Headquarters Credit Union to the 11,000-member Potlatch No. 1 Federal Credit Union.

Each of these credit unions has, in their own way, taken steps to protect those members who will be directly affected by the Potlatch layoffs. For instance, Potlatch No. 1 Federal Credit Union last week assigned two of its employees the task of contacting each of the affected employees who has a loan with the credit union in an effort to rewrite the terms of their loan so that each of these affected employees can satisfactorily maintain their obligations despite their layoffs. This active participation on the part of the credit union in helping its members through what will prove, no doubt, to be very trying times is but one example of how credit unions assist their members.

You can correctly conclude that we contend taxation would put an end to this kind of credit union practice. And I can understand how you might have reservations accepting this contention. But we honestly believe that if we could convey to you the relationships and principles which have combined to form the credit union system, you would clearly see the devastation from the unintended side effects of taxing this movement.

It is not possible to simply extract a small amount of tax revenue from credit unions and leave everything else untouched. Taxation will have the effect of altering the very unpinning of the credit union movement: its nonprofit orientation. It is upon this foundation that the differences between the credit union system and that of the banks and savings and loans have been built. In Idaho, taxation will cause a disruption of basic financial services by credit unions and will open credit unions up to the potential for serious safety and soundness problems.

The tax exemption has come to symbolize the public policy understanding between the credit union movement and the Federal Government. In exchange for the small amount of revenue lost by exempting credit unions from taxation, there has been returned an abundance of social benefits far in excess of the revenue loss.

The credit unions qualified for their exempt status based on being organized and operated on a nonprofit basis. They have no capital stock, are mutually controlled by their members with each member having one vote, they're directed by volunteers, and most have close relationships with their sponsoring organizations. These conditions remain true today.

However, Senator, I believe the decision before the Congress is not whether credit unions qualify for an exemption, which they do, but whether the exemption is still warranted. I personally believe credit unions are contributing more today than ever before and that their exempt status has a lot to do with this. There are several reasons for this, which I have listed in my written testimony, Senator, and I'll not go over those at this time.

Senator, the following list of social benefits are derived in large part from the Federal policy which has existed toward credit unions. The keystone of this policy is the tax exemption.

First, the credit union financial system is in excellent financial condition. Because of its willingness to manage its own problems, there exist no major potential Federal liabilities. This is not true of other financial systems.

Through mutual self-help within the credit union movement, there is now in place a separate system to meet the liquidity, regulatory, information, and insurance needs of all credit union members.

There are over 1,800 volunteers serving as directors and committee members in credit unions in Idaho. 33 percent of all credit unions have no full-time employees.

Over 300,000 Idahoans are receiving financial services from 136 Idaho credit unions. Of these, 72 have less than $1 million in assets, 45 are in the $1 to $5 million range, and 19 have more than $5 million in assets. They range in size from the 44-member Farmer Oil Credit Union with $21,580 in assets to the over 25,000 members of Idaho Central Public Employees Credit Union with its $40 million in assets.

In 1984-85, the credit union system used its resources to fully capitalize their central bank and their Federal insurance fund. This action reduced the Federal deficit by $1 billion. If credit union growth is not interrupted by taxation, estimates show that further capitalization will reduce the Federal deficit an additional $1 billion by 1990, and by the year 2000, a total reduction of $9.2 billion.

This concept for the reduction of the Federal deficit was instituted at the request of credit unions, was designed by credit unions, and was voluntarily effectuated through the contributions of each credit union insured through the National Credit Union Share Insurance Fund.

In our judgment, the following actions would occur within the credit union system if it were taxed. Obviously, the individual actions of credit unions will vary. But overall, I am convinced that the credit union movement will suffer the following disruptions and the impact will be permanent.

The safety and soundness implications are seriously troublesome. Since credit unions have no capital stock, they must use their undivided earnings as a means of preparing for major changes or unexpected market forces. The impact of the Treasury II plan on overall credit union equity would be devastating.

For example, if the plan had been in effect during the period 1979 to 1984, the cumulative reduction in overall equity—that's reserves and undivided earnings—would have been 20 percent.

In other words, taxation would reduce the present equity level of the credit union movement in Idaho from 7.1 percent, or $25.9 million, of assets to 5.7 percent, or $20.8 million. This is at a time when the FDIC is recommending an increase in the minimum capital level for banks to 9 percent and when the savings and loan industry is seeking desperately to find new forms of capital. Potential Federal Government liability to guarantee the soundness of credit unions would be dramatically increased if this tax plan were passed.

In order to minimize the impact of taxation, individual credit union managers will find themselves forced to adopt a tax avoidance strategy.

I think the Senator has heard a lot about tax avoidance strategies here this morning.

All management decisions in credit unions would then be tempered by their tax implications. Almost instantly, credit union management will become profit driven.

Pressure would mount to eliminate free and unprofitable services. Small loans, financial counseling, low balance sharedraft—checking—accounts, and no fee accounts are obvious potential victims of such pressures. To seek out the more profitable accounts, pressure would soon arise to permit credit unions to establish a traditional business relationship with the general public.

The financial and paperwork burdens of Federal taxation will be exacerbated as individual States assert their prerogative to impose their form of taxation on credit unions. As I am sure you are aware, the Idaho Legislature routinely implements Federal tax changes into the Idaho tax code.

Is the taxation of credit unions inevitable? I think not. To concede its inevitability is to both fault the original granting of the exemption and to deny the value to the State of Idaho of the credit union contribution.

It has been contended by some that a credit union loses its merit for tax exemption when it grows to a certain size. This contention suggests that a credit union could somehow avoid growing into a taxable size. Unlike banks or savings and loans, credit union growth often grows and occurs as a direct result of its sponsor's growth. For instance, the Albertson's Employees Federal Credit Union is now twice as big as it was 5 or 6 years ago. Its growth has mirrored the growth and expansion of its sponsor. The same is true for many other Idaho credit unions. Yet, despite their size, these credit unions continue to provide their members with all of the services they have come to expect from credit unions. They have paid generous dividends and charged little or no fees for their services. Their concentration has been on accumulating savings, thereby making credit available on reasonable terms to persons who might not otherwise get it.

The real point here is that these credit unions have been able to retain their basic credit principles while reaching substantial size. It seems totally counterproductive to impose a tax on this group of credit unions solely because of their size.

In closing, Senator and Congressman, I would like to reemphasize two points: First, it simply is not possible to extract a little tax revenue from credit unions and to expect that everything else will be untouched and, second, as long as credit unions continue to return social benefits far in excess of any revenue loss, it makes sense to perpetuate such an arrangement.

I thank you for the opportunity to appear here today, and I would be happy to answer any questions.

[The prepared statement of Mr. Cameron follows:]

PREPARED STATEMENT OF ALAN D. CAMERON

Senator, I am pleased to be here today to present the views of the Idaho Credit Union League on the matter of credit union taxation. The Idaho Credit Union League is an association of credit unions doing business in the State of Idaho. Through its 112 member credit unions, the Idaho Credit Union League represents approximately 202,000 members in the State of Idaho.

I pesonally have been involved in the credit union movement since 1970. For the past eight years I have been the attorney for the Idaho Credit Union League.

I come here today in hopes that I may briefly demonstrate for you the present nature of the credit union financial system and its very people-oriented 51-year history. At the same time, I hope also to convince you that reversing present credit union tax policy would forever remove the nonprofit consumer orientation which presently provides the focal point of the credit union movement. In doing so, I am representing the interests of all Idahoans who are credit union members because there is no doubt that they would be hurt by a change in the present credit union tax policy.

While the taxation of credit unions would affect each of its members, the brunt of taxation would likely be borne by the marginal segment of the credit union population. In contrast, the more affluent members of each credit union would probably be "inconvenienced" by taxation. They would complain about a fee increase or a decline in their savings rate; some might transfer their funds elsewhere; but their quality of life wouldn't really be hurt. Unless fees were dramatically raised, some might never know the difference. But each credit union has its younger members just starting out, or the elderly on fixed incomes, or a group with an economic disruption such as a strike or plant closing. It is these people who will feel acutely the loss of the credit union's ability to provide them with free financial counseling, free transportation to the credit union for elderly members, free life savings and credit disability insurance and on and on. Additionally, the spectre of taxation may require some credit unions to take a more aggressive stance against those members who have found themselves in financial difficulty and are unable to repay their loans. Credit unions are well-known for working with their members during trying financial times but, as I think you'll see, the effect of credit union taxation would likely be to make it economically impossible for credit unions to do so in the future.

Senator, I know you are aware of the recent developments concerning the Potlatch Corporation in the Lewiston area. Potlatch Company employees are served by at least four credit unions ranging from the 538 member Headquarters Credit Union to the 11,000 member Potlatch No. 1 Federal Credit

Union. Each of these credit unions has, in their own way, taken steps to protect those members who will be directly affected by the Potlatch layoffs. For instance, Potlatch No. 1 Federal Credit Union last week assigned two of its employees the task of contacting each of the affected employees who has a loan with the credit union in an effort to re-write the terms of their loan so that each of these affected employees can satisfactorily maintain their obligations despite their layoffs. This active participation on the part of the credit union in helping its members through what will prove no doubt to be very rough times is but one example of how credit unions assist their members.

You can correctly conclude that we contend taxation would put an end to this kind of credit union practice. And I can understand how you might have reservations accepting this contention. But we honestly believe that if we could convey to you the relationships and principles which have combined to form the credit union system, you would clearly see the devastation from the unintended side affects of taxing this movement. It is not possible to simply extract a small amount of tax revenue from credit unions and leave everything else untouched. Taxation will have the effect of altering the very underpining of the credit union movement: its nonprofit orientation. It is upon this foundation that the differences between the credit union system and that of the banks and savings and loans have been built. In Idaho, taxation will cause a disruption of basic financial services by credit unions and will open credit unions up to the potential for serious safety and soundness problems.

Why is the tax exemption so pivotal in the credit union story? The answer to this is part economic, part historical, part circumstance, and part the intended result of a policy decision. Even within the credit union movement itself, the full realization of how central a role is played by this exemption was only recently reached. Due to the severity of the present tax threat, we have more fully analyzed the affects of taxation. This analysis has given us a fuller appreciation of the dimensions of taxation.

The tax exemption has come to symbolize the public policy understanding between the credit union movement and the Federal Government. In exchange for the small amount of revenue lost by exempting credit unions from taxation, there has been returned an abundance of social benefits far in excess of the revenue loss. The credit unions qualified for their exempt status based on being organized and operated on a nonprofit basis. They have no capital stock, are mutually controlled by their members with each member haivng one vote, are directed by volunteers, and most have close relationships with their sponsoring organizations. These conditions remain true today. However, Senator, I believe the decision before the Congress is not whether credit unions qualify for an exemption (which they do), but whether the exemption is still warranted. I personally believe credit unions are contributing more today than ever before and that their exempt status has a lot to do with this. There are several reasons for this. First, and foremost, credit union boards presently make decisions purely based upon the needs of their members; they are free from the artificial influence of the tax code.

Second, the tax exemption has existed for forty-eight years. It was reaffirmed in 1951 and 1961. It has become important for the movement to retain the image and respect of this exempt status. Therefore, we are motivated both through pride of accomplishment and fear of losing the exemption. Both cause decisions and actions which are in the credit union member's favor. The very existence of the exemption preserves the practice of basic credit union principles.

Third, the combined results of credit union principles and federal policy have produced a fully completed financial system at no cost to the government which is in excellent health and which offers a reliable and rapidly expanding source of low cost consumer credit (presently over $100 Billion Dollars nationwide). This system is dedicated by law to the extension of consumer credit.

Senator, the following list of social benefits are derived in large part from the federal policy which has existed toward credit unions. The keystone of this policy is the tax exemption.

The credit union financial system is in excellent financial condition.* Because of its willingness to manage its own problems, there exist no major potential federal liabilities. This is not true of other financial systems.

Through mutual self-help, there is now in place a separate system to meet the liquidity, regulatory, information and insurance needs of all credit union members.

Close personal service is given to all members regardless of their income or size of accounts. This includes financial counseling and the promotion of good credit and savings habits. Basic lifeline services are always available to members of credit unions, usually at little or no cost.

There are over 1,800 volunteers serving as directors and committee members in credit unions in Idaho. 33% of all credit unions have no full time employees.

---

*See, 1984 Annual Report of the National Credit Union Administration.

Over 300,000 Idahoans are receiving financial services from 136 Idaho credit unions. Of these, 72 have less than one million dollars in assets, 45 are in the one to five million dollar range and 19 have more than five million dollars in assets. They range in size from the 44 member Farmer Oil Credit Union with $21,580.00 in assets to the over 25,000 members of Idaho Central Public Employees Credit Union with its $40 million dollars in assets.

Idaho consumers receive convenient and low cost services from their credit unions. For instance, while most banks and S & L's have a minimum loan level, credit union members can always borrow only what they need. These small loans, as obviously uneconomical as they are, provide a service to the membership which we are loathe to discontinue. Credit unions can provide this service, and others such as lower loan rates, because of their lower operating costs realized due to their volunteer boards, limited field of membership, nonprofit statutes and close relationship with their sponsors.

In 1984/1985, the credit union system used its resources to fully capitalize their central bank and their federal insurance fund. This action reduced the Federal deficit by one billion dollars. If credit union growth is not interrupted by taxation, estimates show that further capitalization will reduce the Federal deficit an additional one billion dollars by 1990 and by the year 2000, a total reduction of $9.2 billion dollars. This concept for the reduction of the Federal deficit was instituted at the request of credit unions, was designed by credit unions, and was voluntarily affectuated through the contributions of each credit union insured through the National Credit Union Share Insurance Fund.

The credit union system has stressed credit union cooperation. It is not based on credit union competition. Like the other systems, it has been subjected to severe economic shocks. But a crisis of confidence has been avoided because of the credit union philosophy of working together.

I have inserted at this point in my testimony a chart prepared by the Credit Union National Association which demonstrates the dollar impact of Treasury II.

In our judgment, the following actions would occur within the credit union system if it were taxed. Obviously, the individual actions of credit unions will vary. But overall, I am convinced that the credit union movement will suffer the following disruptions and the impact will be permanent.

CASE I
PRESIDENT'S TAX PROPOSAL
1984 Data

GROSS INCOME: includes all income (including non-operating income)
NET INCOME: allows exclusion of operating expenses (excluding provision for loan losses), dividends, interest payments and net loan charge-offs
TAXABLE INCOME: equals net income
TAX RATE: marginal rates rising from 15% to 33% of taxable income
TAX AVOIDANCE POTENTIAL: Minimal
TREASURY REVENUE (1984): $350 million

		For Credit Unions Paying Tax:				
Asset Size ($ Millions)	Percent of Credit Unions Paying Tax	% With Tax Greater Than Transfers to Undiv. Erngs	% With Neg. Transfers to UDE Paying Tax	Tax as Percent of Gross Income	Tax as Percent of Transfers to Undivided Earnings	Average Tax
$ 0.0 - 0.2	0.0%	0.0%	0.0%	0.0%	0.0%	$ 0
0.2 - 0.5	0.0	0.0	0.0	0.0	0.0	0
0.5 - 1.0	0.0	0.0	0.0	0.0	0.0	0
1.0 - 2.0	0.0	0.0	0.0	0.0	0.0	0
2.0 - 5.0	0.0	0.0	0.0	0.0	0.0	0
5.0 - 10.0	94.6	7.4	6.5	2.8	37.5	23,600
10.0 - 20.0	94.8	9.8	4.4	3.3	46.4	55,700
20.0 - 50.0	96.0	14.0	6.5	3.3	51.4	120,500
50.0 & Over	98.7	16.5	5.5	3.2	56.2	432,300
TOTAL	19.3%	10.4%	5.8%	3.2%	50.9%	$ 98,800

Formula

Gross Income
- Operating Expenses
+ Provision for Loan Losses
- Net Charge-Offs
- Dividends & Interest
= TAXABLE INCOME

TAX RATES

Taxable Income	Tax
Below $25,000	15% of Taxable Income
$ 25,000 - $ 50,000	$ 3,750 + 18% of Taxable Income over $25,000
$ 50,000 - $ 75,000	$ 8,250 + 25% of Taxable Income over $50,000
$ 75,000 - $140,000	$14,500 + 33% of Taxable Income over $75,000
$140,000 - $360,000	$35,950 + 37.66%* of Taxable Income over $140,000
Over $360,000	A flat 33% of Taxable Income

* The Treasury Plan contains no specific details on how CUs with incomes of $140,000-360,000 should calculate their tax liability. However, CUNA economists recommend using 37.66% to calculate their potential tax liability. This figure accommodates the anomaly which occurs at $360,000 when the graduated rates abruptly end and the entire income is suddenly subjected to the 33% rate.

The safety and soundness implications are seriously troublesome. Since credit unions have no capital stock, they must use their undivided earnings as a means of preparing for major changes or unexpected market forces. The impact of the Treasury II plan on overall credit union equity would be devastating. For example, if the Plan had been in effect during the period 1979 to 1984, the cumulative reduction in overall equity (reserves and undivided earnings) would have been twenty percent. In other words, taxation would reduce the present equity level of the credit union movement in Idaho from 7.1% (or 25.9 million dollars) of assets to 5.7% (or 20.8 million dollars). This is at a time when the FDIC is recommending an increase in the minimum capital level for banks to 9% and when the savings and loan industry is desperately seeking new forms of capital. Potential Federal Government liability to guarantee the soundness of credit unions would be dramatically increased if the tax plan were passed.

Further, taxation has to strike at the heart of the system's willingness to take care of its own problems causing it to, instead, look to the Federal Government for protection and continuance of its share of the financial market.

In order to minimize the impact of taxation, individual credit union managers will be forced to adopt a tax avoidance strategy. All management decisions will be tempered by their tax implications. Almost instantly, credit union management will become profit driven.

Pressure will mount to eliminate free and "unprofitable services." Small loans, financial counseling, low balance sharedraft (checking) accounts, and no fee accounts are obvious potential victims of such pressures.

To seek out the more "profitable" accounts, pressure would soon arise to permit credit unions to establish a traditional business relationship with the general public.

As part of this trend, we will likely seek the loss of the volunteer force within the movement as a direct result of taxation. The loss of volunteers and the volunteer spirit could be one of the most expensive social costs of taxation.

The overall financial condition of the system will feel the impact of collective decisions to increase yield by increasing risk. The danger is minimal in a "member driven" system which accounts, in a significant part, for today's relative health in the credit union movement.

The financial and paperwork burdens of federal taxation will be exacerbated as individual states assert their prerogative to impose their form of credit union taxation. As I am sure you are aware, the Idaho Legislature routinely implements federal tax changes into the Idaho Tax Code.

You should also be aware of the financial reform implications of taxation. As credit union management philosophy shifts from service (or member) driven to profit (or tax avoidance) driven, it will be entirely appropriate to expect a series of requests for credit union legislative changes. A preliminary assessment leads me to suggest some of the following: some method of raising capital stock; the ability to convert to stock ownership; the ability to pay all board members; a method to eliminate free and unprofitable services or accounts (this would probably best be accomplished by having different classes of membership and/or by eliminating the membership concept and simply establishing a traditional business relationship with the general public); and certain new investment authorities to permit the chance for higher yields on investments. I am sure we will want to rethink the capitalization of the National Credit Union Share Insurance Fund if the premiums became tax deductible. As you can see, the real cost of taxation will not be measured just in dollars.

Is the taxation of credit unions inevitable? I think not. To concede its inevitability is to both fault the original granting of the exemption and to deny the value to the State of Idaho of the credit union contribution.

It has been contended that a credit union loses its merit for tax exemption when it grows to a certain size.

This contention suggests that a credit union could somehow avoid growing into a taxable size. Unlike banks or savings and loans, credit union growth often occurs as a direct result of sponsor growth. For instance, the Albertson's Employees Federal Credit Union is now twice as big as it was five or six years ago. Its growth has mirrored the growth and expansion of its sponsor. The same is true for many other Idaho credit unions. Yet, despite their size, these credit unions continue to provide their members with all of the services they have come to expect from credit unions, have paid generous dividends and charged little or no fees for their services. As do all other Idaho credit unions, the concentration is on accumulating savings thereby making credit available on reasonable terms to persons who might not otherwise get it. The point is that these credit unions have been able to retain their basic credit principles while reaching substantial size. It seems totally counterproductive to impose a tax on this group of credit unions solely because of their size.

We often encounter the contention that credit unions have an unfair advantage and that they should be forced to play on the proverbial level playing field. Well, first of all, the credit union advantage is a consumer advantage. People do have an advantage through their credit union. There is no inner group of stockholders or officials which benefits personally from the success of the credit union.

Second, the real credit union advantage comes from its nonprofit structure, the volunteers, the close sponsor relationships, and the mutual ownership. Third, a healthy financial system is hardly an unfair advantage and certainly not one to consider removing. Fourth, the Federal Reserve Bulletin of June, 1985, shows that credit union's percentage of the total savings market was 4.8%. Their share of the consumer installment debt (credit) had fallen from 17.1% in 1976 to 15.1% in February, 1985. For further reference, total credit union assets in the State of Idaho are less than those of the Idaho First National Bank alone.

Occasionally, it is suggested that the tax exemption should be removed because a credit union is offering a service that is not available when the tax exemption was granted. There are certain obvious points that must be made regarding this contention. First, the powers which credit unions received since the tax exemption was granted were ancillary to consumer savings and lending. They did not move credit unions away from their basic purpose. They were, of course, granted by Congress, but were not granted with the proviso that the tax exemption was at stake. Second, the newer powers which credit unions have received merely reflect the changes in business practices which have occurred in the past 50 years. For instance, credit unions weren't originally given the authority to offer credit cards when they received their tax exemption because such cards hadn't been developed then.

In closing, I would like to re-emphasize two points:

First, it simply is not possible to extract a little tax revenue from credit unions and to expect that everything else will be untouched; and,

Second, as long as credit unions continue to return social benefits far in excess of any revenue loss, it makes sense to perpetuate such an arrangement.

The administration's plan justifies keeping some exemptions in the Tax Code. These include the home mortgage deduction, special treatment of social security and veterans disability benefits, and itemized charitable deductions. The administration explains retaining these tax preferences on the grounds that "they are widely used and generally judged to be central to American values." Credit unions clearly fall into this general category. Their exemption is "widely used" by 52 million people nationwide to further habits of thrift, prudent borrowing and volunteer service. Their stories abound with examples of traditional American values. Retaining the credit union exemption will foster these values.

I thank you for the opportunity to appear here today. I will be glad to answer any questions.

Senator SYMMS. Thank you very much for your excellent statement, Mr. Cameron.

Martin Hurbi, please proceed.

STATEMENT OF MARTIN HURBI, CPA

Mr. HURBI. Senator Symms, Congressman Craig and members of the committee, my name is Martin Hurbi. I am a certified public accountant licensed in the States of Idaho and Washington.

I have worked with an international accounting firm, a regional accounting firm in Idaho, and am currently the controller of an Idaho bank.

The opinions that are presented here today are mine personally, and not necessarily those of my employer.

I'm not going to talk to you about how or which Idaho industries would be affected by the President's tax proposal. Instead, I would like to talk a few moments about the concept of tax reform.

What is the purpose of the proposed tax reform? Increased revenue for the Government? I think not. The plan has been touted as revenue neutral; however, I wouldn't be surprised if it happens to raise more money.

Tax equality could be another option. It would be nice if everyone paid their fair share, but how do we accomplish this? It seems that every special interest group has a section of the code written just for them.

Tax simplicity? From the President's message on tax reform that was introduced, it appears that this is what we are trying to accomplish, but is that what's really happening?

The President's proposal to lower individual rates to a maximum of 35 percent is commendable and a good start. The rates need to be lower than that, as the lower the rates become, the less profitable tax avoidance becomes.

Aside from high tax rates, the nightmarish complexity of our Tax Code is the major problem, and this is what people want most changed. If we could greatly simplify the Tax Code, the problem of tax equality would soon follow.

Let us discuss tax simplicity. Although there are many proposed changes that serve to simplify the code, there appears to be just as many that would serve to complicate the code.

The interest deduction is a good example. Currently, interest is deductible. Under the proposal, interest is deductible if it's on your principal residence, incurred in a business, or not over $5,000 plus passive investment income.

I'm sure there is some reason for these rules, of which I'm not aware, but I am certain that simplicity is not one of them. Let's not confuse the issue. Either it's deductible or it isn't; no exceptions.

State and local income taxes is another. Currently deductible, under the proposal they would be nondeductible unless attributable to a business. I can see now all the various schemes that will be born to attribute these to a business. This is not simplicity. If we can't make it any better, let's leave it alone.

The business meal deduction is one of my favorites. Currently, meals in a quiet business environment are deductible. Under the proposal, meals are deductible unless they happen to cost more than $25 per person, then one-half of the excess over $25 is deductible. It would cost most companies more in deductible salary costs to keep track of these meals than the IRS will ever gain by limiting the deduction for them. Again, tax simplification was forgotten here.

If any proposed tax change is not simpler than what we have, let's not do it. We have enough complication in our lives and in the Tax Code; we don't need any more.

If our lawmakers can get tough and really simplify the code, we will be making some headway. This means some people will be hurt along the way and some will benefit.

The ultimate result of the push for simplicity will, by its nature, result in a code that taxes all equally, which, in turn, will give us a tax system that is intended to raise revenue, not direct our economy by a complicated maze of special interest deductions and exceptions.

I thank you for your time today and hope you take this to heart.

Senator SYMMS. Thank you very much for a very concise and excellent statement.

Our next witness is one of my favorite State representatives, the speaker of the Idaho House, Tom Stivers. And I've had the opportunity to scan through his statement, and I can say that, once again, the speaker has come up with a statement that's going to be very easy for everybody to understand.

So please get the mike over there so they can hear you.

STATEMENT OF HON. TOM STIVERS, SPEAKER, IDAHO HOUSE OF REPRESENTATIVES

Mr. STIVERS. Thank you, Senator Symms and Congressman Craig. It's good to have this seminar and this briefing session, I think, on tax reform.

One thing that disturbs me a little bit, so far this morning no one has opened up about a taxpayer; a little taxpayer. And I think we have to consider that somewhere down the line.

Most all of these people that have been talking this morning are special interest groups, and I have no problem with business or some of their other businesses they're talking about.

But all of the time that we have been talking about the tremendous load of our Federal tax rates and our Federal tax loads, no one has come forth with any suggestions for amendments.

Now the administration has come out with a pretty good-sized package of amendments and reform proposals and simplification, and everyone wants to attack it.

As indicated in my prepared statement, I did appear before the President's committee in Washington, DC, the latter part of June and spoke on this issue directly. The fact that everyone there, with my exception perhaps, said:

> Mr. President, we're all in favor of your tax program. It's a wonderful thing to have you do this. And we're sure it's time that it's being done. However, my State cannot support this, my city cannot support this, my county cannot support, my special business interests cannot support this.

So piece by piece, they are intent on tearing it apart. And I think it's about time that we took a look at the whole picture and see who is going to benefit, to what degree shall we modify some of the provisions.

And I think the mining and timber industries this morning that testified have some good points on depletions and those types of things. There can be some modifications made there.

But in the long run, somebody has got to be looking at, as I indicated in my prepared statement, "Joe Taxpayer." And no one has spoken for him yet.

I think if you looked through the prepared statement, one of the associations that will be speaking on—we got a little close to it this morning, with the real estate commission, real estate board here. They have for years been pushing through the National Association of Home Builders for more and more subsidizing. And we have a proliferation of subsidized housing in the State at the present time, and one of my major activities in my area right now is making out foreclosure reports or preparing deeds in lieu of foreclosure on subsidized housing in Twin Falls County. And that's an indication that that entity is overbuilt, and now they want to protect it further by continuing the tax advantages of mortgage loans without tax-free mortgage loans.

The Board of Realtors is crying about the elimination of deduction for second homes, interest payments on second homes, on mortgages of second homes.

I made in my second statement—I'm not aware of any case in which a second home is either in a resort area, a vacation cabin or a lakeside or seaside resort. My experience in the market in Sun Valley tells me that 90 percent of the people buying second homes in Sun Valley could care less about the tax interest deductibility. You would have a hard time finding a second home in Sun Valley for less than $100,000. Most of them are in the $350,000 to $950,000 range, and I have little time to worry about people buying homes at that price.

As a matter of fact, we do own a condominium in Sun Valley. I never even considered the tax possibility of having deductibility on the interest rate on that tax—or that real estate tax on my condominium. I have never entered into it. We were going to buy one, and we bought one anyway. And everybody up there buys one with the same attitude.

They aren't—first thing, they don't ask the realtor: "Do I get tax exemption on the interest payments I make? Do I get that? Do I get to do all these other things?"

They're going to buy those in any event.

A recent editorial by Sylvia Porter, who I identify as a true liberal's excuse for a financial adviser, in a recent article commiserates on the elimination of deductions for entertainment expenses such as club dues, tickets to the theater, the World Series, the Super Bowl, and so forth. Also limits on deductibility of business meals. Only the first $25 per person, as the gentleman has already indicated. I don't think that's a terrible thing to hit people with at all, in that tax area.

We should eliminate these cushy deductions for upper income individuals and make it possible to reduce tax rates for all taxpayers.

After all, this is what happens: The special interest groups only argue the loss of deductions while the other side of the coin is the lowering of tax brackets for individuals and corporations.

Now, no one has mentioned that this morning, that there is, under the proposal, tax bracket lowering for individuals and also for corporations. You hear very little discussion on this side.

I think some of the comments that I made notes about this morning, the gentleman from the real estate board said that the Idaho housing industry was providing low income housing.

I wonder if there is anybody in Boise at the present time or in the State of Idaho, in what is defined as low-income bracket, has ever tried to get a loan through Idaho Housing at the present time. They can't do it. They cannot qualify. Those loans go up to as high as $68,000 on new construction. There is no way that those people can qualify for those types of homes, and they don't have anything available in the low-income bracket.

Someone said the local units of government have only one source of income, and that was the income tax. And that's not true. Local units of government have sales tax revenue coming in; we had just increased it last year for cities and counties.

Liquor funds coming into the local units of government, highway fund; all those supplement income taxes and property taxes in those areas.

Everyone is going around saying, "We support this tax movement." I mentioned that earlier. Everyone says, "Boy, it's really nice." They talk about tax simplification and tax reform, and all that, but don't do anything about it.

Now, some questions have been asked here this morning about which is more important: Addressing the problem of the budget deficit or tax reform and tax simplification?

I think they have equal importance, by the way. Nothing is going to be done about tax reform if we don't do something about the budget. That's accepted fact. You can't start in with tax reform if we're not going to do something about budget deficits. And I would hope that the Congress can address at least two things at the same time.

We're having a hard time with the budget deficit, but somewhere along the line I think they could address both of those issues at the same time.

The insurance industry this morning had quite a bit to say, that they're going to be severely damaged. They were talking about the tax on cash value life insurance. You've got to realize that that insured person will be realizing the benefit on reduced tax rates of income tax all during the time he's paying the life insurance premium. And if he cashes it in upon retirement, or earlier, then if it's on retirement, then he gets additional advantage for being 65 or 62, or whatever he is. So that kind of washes out.

Again, someone should be identifying specifically what some of your charts show as to the advantage of the individual taxpayer and small business when you get down to talking about the responsibility of whether or not we should talk about tax reform.

I have a letter here from Bill Ceverha. I think, Senator, you probably know Bill Ceverha. He's presently national chairman of the American Legislative Exchange Council. He says:

AVAILABLE

> First, the President's tax plan significantly reduces the tax burden on working men and women. Some have isolated the removal of the deductibility of State and local taxes and, looking only at that facet, calculated that individuals would pay more taxes. True, but irrelevant.
>
> In fact, isolating one part of a comprehensive tax package reform is intellectually dishonest.

When you talk about deductibility of State and local taxes, you've got to realize what is happening nationwide. And I mentioned that to you this morning, Senator.

I find out that 8 States out of the 50 realize the advantage of over 50 percent of the tax deductibility. Eight States out of 50 realize the advantage of the tax deductibility over all the other States.

Senator SYMMS. Could I ask a question on that, Speaker? Of those eight States, how much of the population of the United States live in those eight States?

Mr. STIVERS. Some of them are, well, New York, Pennsylvania——

Senator SYMMS. New York, California, Pennsylvania?

Mr. STIVERS. Yes, and Michigan is in there, I think, and Minnesota.

However, there are some smaller States, too; none as small as Idaho in population.

Senator SYMMS. I was just wondering if it was actually 50 percent of the population.

Mr. STIVERS. Oh, no; I don't think it's 50 percent of the population, but let me give you an example.

A documentary just recently on TV, 16 years ago the city of New York decided to build a tunnel under the East River. It was going to cost $70 million, and be completed in 6 years.

Sixteen years later the bill is up to $800 million, and they haven't half finished it, and now they don't think they will ever finish it.

Our taxpayers right here in Idaho are paying for that boondock. And we're paying a healthy amount for it.

That happens all over the country in these large, high-tax rate States. And the reason I say population didn't enter into it, most of those States are the extremely high-rate States. And I have a recent publication from the Advisory Commission on Intergovernmental Relations that points out very specifically those States that have extremely high rates far above their ability to tax.

And New York is a prime example. Their tax rates are much higher than their ability to tax. So the rest of the taxpayers in the country are paying that Federal burden. And I think that should be pointed out somewhere.

But Bill Ceverha has some very good items in his letter here, and I would suggest sometime that you talk to Bill the next time you see him.

Senator SYMMS. Well, would you like to put that letter into the record?

Mr. STIVERS. It would be all right with me.

Senator SYMMS. We'll ask unanimous consent, and we'll insert it in the record at this point.

[The letter referred to by Mr. Stivers follows:]

State of Texas
House of Representatives

Bill Ceverha

P.O. Box 2910
Austin, Texas 78769
(512) [illegible]

July 18, 1985

Dear Fellow State Legislator:

We've all heard and read a great deal about President Reagan's plan to reform and simplify the tax code. Many of us have received mailings from one group or another pointing out the alleged dangers of repealing the deductibility of state and local taxes.

As a Republican State Legislator from Dallas, Texas for the past 10 years, I beg to differ. I don't know of any single organization that can speak for all state legislators in all 50 states, but I do know the ties that bind us. We all represent taxpayers. We all have to levy taxes to keep our state governments operating. And we all know firsthand the stake our state economies have in the condition of our national economy.

I believe the nation's State Legislators should support this comprehensive tax reform plan that includes removing the deductibility of state and local taxes and significantly reduces tax rates on individuals. I say this for three reasons.

First, the President's tax plan significantly reduces the tax burden on working men and women. I don't know about you, but that's who elected me. Some have isolated the removal of the deductibility of state and local taxes and, looking only at that facet, calculated that individuals would pay more taxes. True, but irrelevant.

In fact, isolating one part of a comprehensive tax reform package is intellectually dishonest. We must also look at the reduction in marginal tax rates and the increase in the personal exemption column, along with state and local tax deductibility's repeal. As Congressman Jack Kemp has pointed out, even in New York, taxpayers save more money from the lower rates and higher exemption than is lost through eliminating deductibility. We cannot be misled by those who criticize the entire reform by singling out one part of it while ignoring others that more than compensate.

Second, the tax plan is designed to stimulate economic growth through lower marginal tax rates. The Harris Bank of Chicago has studied the plan, and concludes it will result in a net increase in the gross national product by 1990 of between $430 to $750 billion (1985). As State Legislators, we must look ahead and realize that this would increase revenues flowing into state and local treasuries by over $100 billion in 1990.

Those critics who argue that the various tax reform proposals would harm state governments are failing to look ahead, and are forgetting that economic growth does more for our states than any amount of federal aid. And economic growth comes without the strings and regulations attached to monies from the federal treasury.

Finally, for those State Legislators who believe that there is room to reduce state tax burdens or who oppose further increases in their state taxes, there is little reason for maintaining federal deductibility of state taxes. Knowing that "Uncle Sam will pick up part of the tab" without states shouldering full responsibility, taxes are more likely to go up.

What we are talking about here is accountability. I believe enhanced accountability of State Legislators to the people who elected us is a proper and good thing. And I think that such accountability has much more to do with the American system of government than any sentimentalized description of a tax deduction.

The case for pro-growth tax reform such as President Reagan has suggested is so strong, the benefits so great, that I believe it must receive the support of all of us who are truly concerned about the people we represent.

Many thanks for giving me your time, my good colleagues. Here's to good government!

Sincerely,

Bill Ceverha

Bill Ceverha

P.S.

Why not let the President know how you feel about this today!

Mr. Stivers. Fine. One other item. I do get copies of the American Farm Bureau paper. And they have tax reform's effect on agricultural outline. And some of the things that we haven't talked about this morning is the effect on agriculture.

Well, now, from my part of the State, we don't dig stuff out of the ground except potatoes. We do harvest beans and alfalfa and beets and things like that.

But it says here: "For most farmers, the limit on special tax provisions will be more than offset by rate reduction."

That's what I mentioned earlier.

The other side of the coin is rate reduction. The reduction in marginal tax rates and new limits on special tax reduction will reduce incentives for tax shelter investments in agriculture. One of the things that I'm sure you understand that has hurt agriculture in Idaho more than anything else are these people coming into the State, bringing a lot of money in here, investing it in wheat farms, dairy farms and things like that, get a tremendous depreciation and tax-supported commodities to the—the expense of the basic farmer. And that hurts him because you've got all that additional commodity on the market, depresses the price, and that farmer—the basic farmer cannot compete with that because he's having to pay the full bore on his fertilizer and everything else, and doesn't get on those schedules.

I'd just mention that the Farm Bureau Federation certainly is not opposing this tax proposal.

Another thing that was mentioned this morning———

Senator Symms. Well, are they supporting——

Mr. Stivers. I don't see in here—they've got questions and answers here.

Senator Symms. Well, we're going to have some testimony from that.

Mr. Stivers. I haven't seen them take a position on it, but their own newspaper elucidates the advantages of that program. They don't come out and say they were supporting it or opposing it.

The National Federation of Independent Business has some interesting comments to make here. It says the long-awaited Treasury II tax reform plan is finally out. Overall, small business fares well under the President's new plan. NFIB has endorsed the concept of the proposal but we'll be working to make appropriate changes to achieve and ensure rate reductions, true simplification and equity between big and small business.

And I think that's important, that they do make that difference.

There was some discussion that was made earlier today about the tax rate on small business, and it is an escalated rate, and it does have a good protection in there at the present time for small business.

A lot of their comments here about investment tax credit and those items, I think, need to be examined. I have no problem with elimination of investment tax credit to a great extent because it's been abused and confused with a lot of other things.

Industrial revenue bonds and things of that nature are terribly abused at the present time.

And that's about it. I just think that somebody should be speaking up more for the individual taxpayer who by and large is going to get a benefit out of this program. And he will be able to spend his savings back into the economy, and you and I both know that's what generates tax revenue.

Thank you very much.

[The prepared statement of Mr. Stivers, together with a note subsequently supplied for the record, follows:]

PREPARED STATEMENT OF HON. TOM STIVERS

The sky is falling! The sky is falling!

At least that is the perception one gets from all the special interest groups in their discussion of the Administration's Tax Simplification Plan.

The only thing I hear from down on the street and farm taxpayers is to please do something to stop the tax benefits these special interest groups are receiving.

For example, from the National Association of Home Builders, "Regan's Tax Proposals Would Hit Low Income Renters Hardest." The NAHB has for years been pushing for more and more subsidized housing for their own benefit. Never mind that the industry overproduced, and FmHA is foreclosing and taking back on Deed in Lieu of Forsclosure hundreds of low income housing units right here in sunny Southern Idaho.

Now for the other side of the coin. The National Board of Realtors is crying that the elimination of deduction for interest on second homes will ruin the second home market. I am not aware of any case in which a second home is either in a resort area, a vacation cabin or a seaside resort. My experience in the market in Sun Valley tells me that 90% of the people buying second homes in Sun Valley could care less about the interest deductibility. You would have a hard time finding a second home in Sun Valley less than $100,000. Most of them are in the $350,000 to $950,000 range. I have little time to worry about people buying homes at that price.

You have already heard the weeping and wailing about the repeal of state and local tax deductions. A little research reveals that eight states account for over 50% of the deductibility, and all of those states are in high tax rate areas, and their tax revenues are higher than their tax capacity. (See M-142 Tax Capacity of the Fifty States. ACIR 1985)

Sylvia Porter, a true liberal's excuse for a financial advisor, in a recent article commiserates on the elimination of deductions for entertainment expenses, such as club dues, tickets to the theater, the World Series, the Super Bowl, etc., also limits on deductibility of business meals. Only the first $25.00 per person per meal would be fully deductible. Cost of seminars aboard a cruise ship would no longer be deductible. Isn't that too bad!

We should eliminate these cushy deductions for upper income individuals and make it possible to reduce tax rates for all taxpayers. After all, this is what happens, the special interest groups only argue the loss of deductions while the other side of the coin is the lowering of tax brackets for individuals and corporation. You hear little discussion of this side.

On June 27th, I was one of a group of legislators invited to the White House for a briefing on the tax package. To my knowledge, this was the first legislative discussion of the package in any legislative forum. Yet, prior to the meeting, the National Conference of State Legislators sent a directive to all legislative leaders across the country which stated "NCSL has adopted a policy statement opposing elimination of deductibility of state and local taxes." I have been asked by the White House to appear again on August 8th for another up-date.

I think it is interesting to note that the American Farm Bureau Federation has come out with a good analysis of the benefits to most farmers under the tax reform plan. (See Farm Bureau News, June 3rd.) I think it is time we attempt to do something for the basic farm operator and eliminate advantage for speculators to buy additional farm land in Idaho and depreciate the cost out to zero while raising subsidized wheat and operating subsidized dairy farms at the expense of permanent farm operations and taxpayers in general.

I have talked to Joe Maddock of Potlatch and Junior Hinson of Idaho Forest Industries and from information received, the package would have little effect on those industries because they are not in a profit mode anyway.

Senator, the package is not that bad. Remember, Joe Taxpayer thinks it's time something happened.

From the desk of . . .

T. W. STIVERS
Speaker of the House

Senator Symms:

There were actually nine states instead of the eight that I mentioned in my testimony. They are indicated by check mark.

Tom.

TABLE 7

Distribution of Deductibility's After-Tax Value Among the States, by Return, 1982

State	Total $ Value
Alabama	$195,495,000
Alaska	20,166,315
Arizona	219,625,608
Arkansas	114,077,425
California	3,837,616,958
Colorado	338,489,743
Connecticut	422,953,680
Delaware	97,395,811
D.C.	123,830,456
Florida	527,924,112
Georgia	490,131,917
Hawaii	116,304,531
Idaho	62,751,818
Illinois	1,154,217,242
Indiana	278,536,589
Iowa	215,726,434
Kansas	192,528,252
Kentucky	240,348,600
Louisiana	134,293,586
Maine	78,908.100
Maryland	791,367,720
Massachusetts	894,120,353
Michigan	1,309,566,143
Minnesota	621,245,858
Mississippi	101,483,066
Missouri	343,078.657
Montana	33,397,920
Nebraska	138,355,099
Nevada	49,571,450
New Hampshire	64,130,778
New Jersey	1,241,347,226
New Mexico	52,024,342
New York	4,088,785,628
North Carolina	464,258,480
North Dakota	27.579,564
Ohio	885,210,065,
Oklahoma	271,035,971
Oregon	311,283,840
Pennsylvania	986,323,853
Rhode Island	110,989,669
South Carolina	234,986,913
South Dakota	14,308,066
Tennessee	153,051,825
Texas	661,129,185
Utah	142,792,558
Vermont	39,420,421
Virginia	620,142,415
Washington	270,495,909
West Virginia	66,065,340
Wisconsin	651,261,523
Wyoming	17,224,655
Total	24,511,815,100

9 States
account for
1/2 of Deduc

Sources: Internal Revenue Service, Statistics of Income, 1982: Individual Income Tax Returns (Washington, DC: U.S. Government Printing Office, 1984), p. 11; and Office of Tax Analysis, Office of the Secretary of the Treasury, "Tabulations from the 1982 Statistics of Income File for the Fiscal Relations Study," Table 5. December 14, 1984. note: deductibility's value on this and subsequent tables is determined by subtracting each itemizer's tax liability in deductibility's absence from his current tax liability. This "tax savings" takes into account changes in marginal income tax rates and the use of the standard deduction if deductibility were eliminated.

TABLE 9

Distribution of Deductibility's
After-Tax Value Among the States, Per Capita, 1982

	State	Per Capita Dollar Value
1	New York	$231.54
2	District of Columbia	196.24
3	Maryland	185.55
4	New Jersey	166.89
5	Delaware	161.79
6	California	155.22
7	Massachusetts	154.67
8	Minnesota	150.31
9	Michigan	143.77
10	Wisconsin	136.68
11	Connecticut	134.14
12	Oregon	117.51
13	Hawaii	117.01
14	Rhode Island	115.85
15	Virginia	112.94
16	Colorado	111.16
17	Illinois	100.82
18	Utah	91.89
19	Nebraska	87.24
20	Georgia	86.92
21	Oklahoma	85.31
22	Pennsylvania	83.13
23	Ohio	82.03
24	Kansas	79.95
25	North Carolina	77.13
26	Arizona	76.79
27	Vermont	76.40
28	Iowa	75.29
29	South Carolina	73.36
30	Missouri	69.70
31	Maine	69.65
32	New Hampshire	67.44
33	Kentucky	65.54
34	Idaho	65.03
35	Washington	63.72
36	Nevada	56.27
37	Indiana	50.91
38	Florida	50.68
39	Arkansas	49.79
40	Alabama	49.58
41	Alaska	46.04
42	Texas	43.27
43	Montana	41.70
44	North Dakota	41.31
45	Mississippi	39.78
46	New Mexico	38.28
47	Wyoming	34.31
48	West Virginia	33.91
49	Tennessee	32.91
50	Louisiana	30.79
51	South Dakota	20.71
	National Average	105.87

Sources: Table 7; and U.S. Bureau of the Census, Statistical Abstract of the United States, 1984 (Washington, DC: U.S. Government Printing Office, 1983), p. 11.

Senator **Symms**. Thank you very much, Mr. Stivers.

Mr. Stivers, let me ask you one question.

I don't know whether you have had the opportunity to look at the Kemp-Kasten proposal, but the Kemp-Kasten proposal and the President's proposal—basically, the philosophy is the same behind them. But the Kemp-Kasten proposal does not take on every single tax preference that's currently in our Tax Code. They leave a lot of things alone. They leave minerals and oil and gas and timber production, and some of those things alone. And then they do the other side of the part that you're appraising, reducing the rates; that's what I have personally said all along. I favor reducing tax rates.

Where I have trouble is, this part of coming in and decimating a company that's competing internationally.

Now, you know, I hear what you're saying and I appreciate what you're saying, but as long as the Senate Finance Committee operates under the doctrine of revenue neutrality, how do you suppose or how do you propose we're ever going to get reduced tax rates and tax reform, because you have the number counters at the Treasury looking back at last year's economic—you know, what people did last year; they don't look to what people might do next year.

So we get into a situation where they say to me, "Well, if you want to protect whatever tax preference it is, some of those like State and local taxes, you may well be right; we can afford to give those deductions up maybe in investment tax credits. But we're put in the position, as members of the committee, that if we want to protect, say, timber and minerals to keep these jobs alive in Idaho, then they say, "Well, who are you going to raise the taxes on?"

And I'm coming back and saying, "They're counting their numbers wrong."

Do you have an answer or any advice for me on that point?

Mr. **Stivers**. Well, I have an answer. I don't know whether I'd have any advice or not.

You and I both know that this Treasury II package is not going to fly in its present form; that's the accepted fact.

I hope it's modified and amended and—there isn't a bill that we'd pass to the legislature that doesn't have some problems with it and we go back and rehash it again.

But I'm hoping that the basic concept of—I don't like to use the word "reform" because that always indicates somebody is going to raise your taxes, but a simplification plan somewhere, where those that are getting special benefits now are going to have to bite the bullet a little bit.

And I won't deny in some areas that maybe some investments I have, I'm going to have to give up. That's fine with me, because ultimately my individual tax rate will be lowered and somebody else's is going to be lowered. That's going to help the economy in the State of Idaho.

And I think that's what your committee should be looking at and coming up with some suggestions of a modification where we can try to answer——

Senator **Symms**. Well, what would you say about a proposal where, if you finally agreed where you wanted to get to on tax reform and then said, "We'll pass this, and we'll be there in 10 years from now," and you just go so much a year on a formula.

In other words, you want to reduce the rates another 15 percent, that we'll reduce them 2 percentage points a year for the next 10 years and don't have all this upheaval and this disruption, and this confusion and people wondering.

Now, I heard what you said about Sun Valley. And you may well be right about people buying condominiums and second homes. However, on the other side of that coin, one person testified here this morning that there's a lot of property that's being offered for sale but no buyers till people know what's going to happen.

Do you perceive what would happen to the tax base in Idaho if the Federal Government did pass this tax bill and it had a negative impact on the value of property in Idaho and caused it to go down in value because it creates a circumstance where there was less buyers? What does that do for you as a State legislator who is responsible for the State budget and all the property taxes?

Mr. STIVERS. Well, Senator, I don't buy the argument that it causes the values to go down. I think that's figures that are built out of—I don't think they'll cause that much difference. They're down now, not due to the tax problem; they're due to the economy itself, down drastically at the present time.

But I don't think the tax provisions in there are going to cause the values to depreciate, not in any extent.

Senator SYMMS. Larry, do you have any questions for any of the witnesses that testified?

Representative CRAIG. No, I don't. I do appreciate all of your testimony. I appreciate Speaker Stivers beating the drum for the individual taxpayer, because there are some very clear benefits in there.

It has been my argument all along that something like the Kemp-Kasten, that the Senator spoke of, has a greater opportunity of passing this year than to run out, in one fell swoop, and tackle the whole football team, as the administration has attempted to do with this tax reform approach. There is no question it needs some reform, but at the same time, Congress and any administration has never been successful in massive sweeping change all at one time.

And I think it's much more reasonable for us, if our goal is reform, that we take off chewable chunks. Right now they've got a mouthful, and they can't even close their mouth. And that's what we're going to be seeing in the next couple of——

Mr. STIVERS. It certainly has generated discussion, though, hasn't it?

Representative CRAIG. Oh, and that's valuable.

Mr. STIVERS. It has.

Senator SYMMS. Well, Mr. Speaker, it has generated discussion, and I guess I might say my biggest disappointment about it is that there is a true flat tax bill that has been worked on for years by the Hoover Institute of Stanford that, if the President had taken that as his position, he could have the same discussion he's having but he would truly be on the high moral ground because he would be talking about doing away with all deductions and taxing all income only once, closest to the source that it's earned, and that puts the rate down to below 20 percent, somewhere between 18 and

20 percent—they think 19 percent, but it certainly would be—that would be, in fact, tax reform, because then there would be no bias against savings, because you'd have no deduction for interest but no taxes on dividends or interest, so the person would be encouraged to save money and invest and grow. Businesses would get 100-percent expensing under this plan, and so as long as they kept plowing money back into the business, they could reduce their tax liabilities, and they'd be providing jobs. I mean, it would be a supply-side tax bill.

That's where I wish the President would be for this discussion. And then we might end up with some modified version of that down the road of the Kemp-Kasten proposal or some other version.

But at the present time, I think it's extremely difficult for those of us on the committee to be advocating anything that is going to hurt jobs in our State. And that's the way they're doing it; they've got everybody in the corner because of their number accounting.

And you know and I know that people are going to react differently under a different set of circumstances. They won't—it's like the argument about intangible drilling costs, the Treasury says they'd raise $8.7 billion in intangible drilling cost revenues to the Treasury if they did away with the deduction. And I told them they're crazy because what they'd end up doing is, nobody would drill any wells. So there wouldn't be any money coming in. I mean, it would be awash; there would be nobody drilling oil wells, because there would be no incentive, the risks are so high. With 9 out of 10 wells being dry, nobody in their right mind would spend their money to do that.

Now, they might buy a condominium in Sun Valley. I agree that you have a good point on that. And I'm open for that. But I'm concerned about it, because there's a lot of people in Idaho that earn a living supporting all of the second homes, you know, Coeur d'Alene, Sandpoint, Sun Valley, Highland Park, McCall, just to name a few places, where it's a real industry of people either building them or servicing them and providing those, and it makes a place for a person to make a living.

Did Joe have any questions, or Rip?

Mr. **Ripley**. No.

Mr. **Cobb**. No, not at this time.

Senator **Symms**. OK. I thank all three of you very much.

Did you have anything you wanted to add?

Mr. **Stivers**. I think I'll—I'll mention your concerns to Ron the next time I see him.

Senator **Symms**. OK. The next thing you might do is, I would like to have those exhibits——

Mr. **Stivers**. Yes. I will get a copy of this made for you.

Senator **Symms** [continuing]. For the record, because that was excellent testimony, and it was badly needed because sometimes I think we all tend to get here and start beefing up on the proposal. There is a bright side to the suggestion that has been made.

I would also like to know if you have the list of those eight States. Now, I listed New York, California, Pennsylvania, Michigan. Do you know the other States?

Mr. **Stivers**. I've got them in my files, Senator, and I think I have them down in my office. I'll get them back up to you.

Senator **Symms**. If it's not too much trouble, or else I can get the committee to dig them out for us. Because it would be interesting to know just how much of the American population would be participating.

Certainly I think you're correct about the high-income people in New York City. Their high taxes are much less of a problem for them because they get the federal deduction, so it's awash for them. So if they're paying 18 percent on their taxes in New York City on their income, they get it washed down to 9, just by the deduction on the Federal Tax Code. And so they have no reason to lean on their local politicians to be more frugal.

Thank you all very much.

Mr. **Cameron**. Thank you, Senator.

[Whereupon the panel members were excused.]

Senator **Symms**. The next panel is Mr. Tom Hoveden, Idaho Cattle Association—I don't see Tom in the room; Mark Armstrong, dairy farmer—is Mark here?

Come on up, Mark.

Andy Anderson, Idaho Petroleum Association. Andy, are you here?

Mr. **Anderson**. Yes.

[Whereupon, the panel members assembled.]

Senator **Symms**. We'll ask to get unanimous consent now, at this point in the record, if he doesn't show up to testify later. If he does show up, we'll then put it at the appropriate place where he does make the testimony.

Mark, you go right ahead, Farmers Group.

STATEMENT OF MARK ARMSTRONG, DAIRY FARMER

Mr. **Armstrong**. Representative Craig, Senator Symms, I've been a dairyman down in southern Idaho for—since I was born, with my father, and grew up as a dairyman all my life.

The reform package that they're talking about will be very devastating to the dairyman. A dairyman's primary purpose is to build the best herd he can possibly build with his young stock being raised instead of having to go out and buy it.

With the proposal that is in the new bill of raising them until they're 19 months old before they can start depreciation on them, taking all the vet bills, all the medical bills and all of these, it would be pouring money down the drain, basically, unless you bought the cows.

The average cost, probably, on a heifer is probably $450 per year. In 2 years, before they're ready to calve, it's $1,900.

The expenses for a 200-cow dairy, you're talking $40,000 a year to bring the number of replacements into the herd, which is a 25-percent cull rate, or 40 head of cattle into that herd. Without being able to take the deductions, you would be looking at this as basically income for 2 years until the calf comes into the milking herd.

Senator **Symms**. Come on up, Tom. We're started with your panel. Get you a seat right over there, either place.

Mr. **Armstrong**. The dairymen right now are having a hard enough time meeting their obligations with the way the dairy program has gone and with all the governmental problems that they have had and everything——

Senator **Symms.** Well, Mark, did you say this proposal is going to raise the taxes on a dairy?

Mr. **Armstrong.** Well, without the deductions for expenses and that, if we have to depreciate the animal out and have to wait 2 years before we start depreciating the animal, basically this is what we've read in the Farm Journal, is that we would have to wait 19 months before we could start taking any depreciation or anything. That's 2 years. And how many dairymen are going to be left in 2 years to be able to take the depreciation?

What's going to happen on this is that the farmers are going to look at their sons and say, "OK. You go into a corporation to raise my calves. I will sell them to you, the day they drop. The day they're ready to calve, I will buy them back. You keep a record book. I will pay you the expenses at the end of the 2 years, whatever the expenses are."

They're just splitting it up. This is what's been done prior in corporations; this is what will happen now. And it will just make another corporation out of the same family farm that is already raising the calves.

Senator **Symms.** How many years have you personally been milking cows? Did you say 19?

Mr. **Armstrong.** I have been on my own 10 years.

Senator **Symms.** Oh, but your dad before you, how long did he milk cows?

Mr. **Armstrong.** Twenty-five or thirty years.

Senator **Symms.** Before that. OK. So from you, I can get an experience thing of, say, 30 to 40 years here?

Mr. **Armstrong.** Correct.

Senator **Symms.** OK. How much has the breed stock improved in just your dad's and your lifetime?

Mr. **Armstrong.** Oh, I can say just in my lifetime, it's improved it basically 5,000 pounds per cow per year.

Senator **Symms.** And a cow produces how many pounds in a year?

Mr. **Armstrong.** I think the State's average probably now is up around to 15,000.

Senator **Symms.** So you're saying they have improved the breeding herds by 30 percent?

Mr. **Armstrong.** Correct.

Senator **Symms.** How much of the money that's invested in producing high quality milk producers, you know, the breeding stock—the registered cows and so forth—comes from people who invest in that and hire somebody to grow that cattle for you; is that an important factor?

Mr. **Armstrong.** This is one of the problems the dairy industry has right now. All this lease money that has come into the dairy industry for dairies and all these various ways that they could get the ITC and the depreciation, this is what's hurting the dairy industry.

These big corporations coming in with millions of dollars and building a dairy and hiring 20 people to run it and saying, "I don't care if you make any money or not. We just want a tax writeoff."

Senator SYMMS. They're not going to want a tax writeoff forever. Sooner or later somebody is going to want to end up, you know, not losing money. But maybe I didn't make my question clear. What I'm trying to ask you is: You now can produce 5,000 or 30 percent more pounds of milk per year than, say, your dad could and you could 10 years ago?

Mr. ARMSTRONG. Correct.

Senator SYMMS. OK. Who developed the livestock that's produced—that gives more milk? Is that the breeding line, or is it just better feed, cultural practices, or——

Mr. ARMSTRONG. It's the generic line that has been developed through the farmers, breeding their own stock, raising their own calves, breeding to selected bulls from other herds, artificial insemination type——

Senator SYMMS. The reason I'm asking the question is, I had a fellow from over around St. Anthony that got ahold of me about this tax bill, and he's in the business of just growing breeding stock.

Mr. ARMSTRONG. Replacement heifers.

Senator SYMMS. In this case, it's not for dairies; it's for beef production.

Mr. ARMSTRONG. Right.

Senator SYMMS. But his complaint to me was that inside, the middle of this bill, there is a section in it that directly attacks his ability to get the people to put their money up for him to grow these high-quality breeding stock. He said that he doesn't think the Treasury Department understands the importance of him being able to attract this money—it's not farmers' money; it's money people invest in it as a——

Mr. ARMSTRONG. Writeoff.

Senator SYMMS. Well, not necessarily a writeoff, but as a way to defer their tax liability or to invest in any capital gains treatment on the cattle—and maybe Mr. Hoveden will want to comment on that when we get to him.

But have you had that experience? You're saying that the farmers have developed these better heifers, and so forth, themselves without any tax——

Mr. ARMSTRONG. Well, you get money from outside sources. You go back into some of these great big—I'm thinking of a sale down in Texas; I can't think of the name right now. But the top cow sold for a $1,100,000. It's not one dairyman paying for that cow, it's a syndicate that's going to syndicate her out. And her bull calf, the day that it's dropped, is worth $50,000 to $100,000, probably.

Senator SYMMS. Because it's a high producer?

Mr. ARMSTRONG. Because it's a high producer. And we can't compete, as small producers, with this outside money like that.

Senator SYMMS. So in other words, you'd rather go ahead and change tax codes so they don't have the break?

Mr. ARMSTRONG. Well, there's got to be a balance here so we can raise our young stuff to improve our own herds, because it would cost us $1,000 every 2 years to replace that single calf on it.

And it could be very hard on you, because you can—you can breed for this production and breed for the generics, but if you have to get rid of that calf the day that it has dropped, you're not gaining a thing. We will go the opposite direction in the dairy business if we have to get rid of our calves and then buy them from somebody else on it.

But in the dairy, this is basically what it would do.

I've got a little article here from the Farm Journal that—there's a quote by a Mr. Ross, and I don't know what his first name was:

> There is no doubt there is tax sheltered money in cattle that contributes to overproduction. What we don't know is how much. The new rules make no distinction between the tax shelter investor and the guy with a hundred cows.
>
> In trying to squeeze out the last tax shelter dollar in cattle, the Treasury will squeeze out the commercial operator just as hard.

It will help family farmers from having to compete with outside money, is what this bill will do.

Senator SYMMS. It will do that?

Mr. ARMSTRONG. It should do that.

Senator SYMMS. I guess the only down-side to that—and I think it's something I'd ask you to think about; you don't have to answer the question right now, but I'm asking a lot of farmers the question. I have a lot of farmers that come up to me around the State and say, "We want to keep all this money out of agriculture. Don't let them take tax losses on farming from income they make somewhere else."

The only thing that worries me about that, as capital starved as we are in agriculture and as up against the wall as we are, as an aggregate group of our debt-equity ratio, you know, it's going to help anybody to try to keep money out of farming, particularly for some farmer who wants to get out of farming.

Mr. ARMSTRONG. Correct.

Senator SYMMS. I mean, there's the other side. Now, like, you're a young man. Your dad may decide he wants to sell his farm. You may say, "Dad, I don't want to buy it because it's not profitable enough," but he may find somebody from Los Angeles that thinks that would be a great deal to invest in and enjoy the depreciation on the milk barn and everything, and acquire a capital asset. And so he finds a buyer.

And then if we pass some law that cuts that person out, I don't know whether he's better off or worse off.

I think that's a question of real concern to me, is what's this impact going to be?

Mr. ARMSTRONG. With the problems we have with the financing people right now, the PCA is going out of business and things like this.

Basically agriculture has to have all the money that they can get. I mean, if it comes from an investment group.

I have looked at this on my dairy, of having an investment group come in and take over it. But they don't know what to do, with what's going to happen.

Senator SYMMS. I know the Farm Journal right there is saying that's good for farmers. But I'm questioning whether their premise is correct. That's what I want you to think about, and you tell me. You just got through saying, "We need all the money in agriculture we can get."

But if we change this thing so it keeps them out, are we better off or worse off as a farmer?

Mr. ARMSTRONG. As a small operator, the small operator will be better off, because he can operate his facilities; and if he's a good operator, he will be able to go to the bank, or whatever lending institution the farmers will have.

The larger corporations, we've got a dairy west of us running around 2,500 head of cows that have been in it for about 7 years. They have resold. Half the board of directors are the same people that owned the first one. They were able to take the tax write-offs again because it was a new corporation.

Senator SYMMS. Senator Abdnor and I had hearings on agriculture here in Boise about 2 years ago on the farm problems, and we had a witness—we had the United Dairymen testify. And they testified that the average cow was producing, I believe it was 50,000 pounds of milk—is that right?

Mr. ARMSTRONG. No; it would probably be closer to 15,000. If you had a herd of cows at 50,000 pounds, you'd have———

Senator SYMMS. 15,000 per——

Mr. ARMSTRONG. Per animal.

Senator SYMMS. Per day; I'm talking about per day. No. He's talking about per day. The United Dairymen had one figure—this one fellow testified, that operates one of these big dairies——

Mr. ARMSTRONG. He was shipping 50,000 per day, probably.

Senator SYMMS. He was claiming that he was milking 70—it was 70 pounds, excuse me. It was 50 pounds for the average; for the United Dairymen's average in Idaho, 50 pounds per cow.

Mr. ARMSTRONG. That's better.

Senator SYMMS. This fellow was saying 70 pounds they were getting.

Mr. ARMSTRONG. Yes.

Senator SYMMS. Do you believe they were getting 70 pounds?

Mr. ARMSTRONG. It's very possible. That's only a 22,000 pound herd.

Senator SYMMS. So we're talking about selling—they were getting 70 pounds per day per cow.

Mr. ARMSTRONG. Right. See, that's only a 22,000-pound herd average, and there are many, many dairymen that are beating that. And this is through raising their animals up and taking care of them.

Senator SYMMS. Did you get completed?

Mr. ARMSTRONG. No; I have got another deal on the fertilizer.

I don't see how any farmer if he has to depreciate his fertilizer as a capital asset, can stay in farming. You get farmers with a budget of $200,000, at least 25 percent and probably more than that, it's fertilizer. You're talking, say, $35,000, $40,000, and then depreciate it over 5 years, you're talking a writeoff of $8,000 a year. Now, what happens to the other $32,000 that year? Does that go in as a taxable asset?

Senator SYMMS. I'm learning something about this tax bill. I didn't know that was in there.

Mr. ARMSTRONG. It is in there. Let me read it.

Senator SYMMS. That's just another example of what I'm talking about the people that write these things; they have never been on the farm, obviously. The farmers are putting the fertilizer on for this year's crop.

Mr. Armstrong. Right.

Senator Symms. He may have a lasting effect, but he's worried about this year; he's not worried about 5 years from now.

Mr. Armstrong. What it states in here is doing away with the fertilizer deduction, rather you must capitalize and depreciate it.

Now, this is going to create problems because the farmers have already got problems. If you're looking at $2.70 a bushel of wheat right now, 10 years ago it was around $4.20.

In 1972, when my second son was born, it was $4.87 the day he was born. That was in the paper.

Now, we're talking almost half the price there that we were getting back in 1972, and our expenses have tripled.

Representative Craig. What's the cost of fertilizer gone up to for the same period of time?

Mr. Armstrong. It has probably tripled.

Representative Craig. Under this proposal, you would not be able to operate by the operating expense?

Mr. Armstrong. Right; and what do you do? Bud Farmer goes out and puts $200 an acre of fertilizer on an acre of ground, or more, and he's got an asset there of $200 an acre he's got to pay taxes on.

Senator Symms. Let me ask you one other question: Do you do accrual accounting, or cash accounting?

Mr. Armstrong. I'd have to ask my bookkeeper.

A Voice From Audience. Cash. We're on cash.

Mr. Armstrong. We're on a cash basis.

Senator Symms. Well, see, my accountant friend here tells me that isn't as big of an issue as I think it is, but I just think that's the absolute biggest outrage I've heard of for the Treasury to come out and want to put farmers on an accrual accounting system.

We don't know what the weather or the prices are going to be in many cases. Anybody that's in the produce business have no idea what they're going to get for the price.

We've got a beet crop coming on at the ranch right now; we don't know what the price is going to be.

Mr. Armstrong. That goes right along with the grain growers and potato farmers, and everybody else here in the State. If it wasn't for agriculture, we wouldn't have a State.

And with some of these deals that they're coming out with, they act like they want to eliminate agriculture. But if they had to go to the shelf of the supermarket tomorrow night to buy Wheaties or get a gallon of milk to eat the next morning and it wasn't there, then what are they going to do? It would be a very interesting situation.

And one other little point that I wanted to bring up on this bill is the version of parents paying money to their kids. They say it's hiding the money under the table. But in our situation, we pay the kids for the work they do on the farm, and I think legally we can take up to $2,600 for their deductions.

Through the course of a year, it costs more than a $2,000 deduction or the $1,500 deduction we get now for our taxes to raise those kids and put clothes on them. And basically what we do is pay them so they can buy their school clothes, their football accessories, or whatever they need for the athletics they're in, and the chasing, and this, and they pay for their own expenses this way.

And some way they need to keep this in the farm end of this reform so that we can pay our children what's due them instead of having to write them off as a hired man and writing them a check for $500 or $600 a month.

Representative CRAIG. Withholding Social Security.

Mr. ARMSTRONG. Right; and it just starts to balloon that up all over again. A child at 14, 15 years old, it's just a little early to start them having to fill out these W-4's and 1040 forms and things like this, to go through their lifetime on.

But basically, this is what I had, and I wanted to bring it up to you today.

Senator SYMMS. Thank you very much.

Mr. ARMSTRONG. I thank you very much for the time.

Senator SYMMS. And I apologize that I kept asking questions. But I think I did learn something about the thing.

And Andy, I'm going to leave you till last. I want to kind of stay on this agricultural question here next and hear from Tom Hoveden of Idaho Cattle Association and other groups in Idaho.

Tom, welcome to the committee.

STATEMENT OF TOM HOVEDEN ON BEHALF OF THE IDAHO CATTLE ASSOCIATION

Mr. HOVEDEN. Senator Symms, Congressman Craig, I got here a little late. I had a lovely morning with the Immigration Service. It's certainly going to help us on our H-2 program, and they're all out to see us legalize that, and we're making great progress there.

In looking at the tax bill——

Senator SYMMS. Are you serious?

Mr. HOVEDEN. What?

Senator SYMMS. Are you serious?

Mr. HOVEDEN. Oh, extremely serious. Oh, we had the No. 1 man from Washington and other people there. And they have done great things. They said:

> Clean this up, dry their backs off, bring them in legally, and then we can go down and catch the smugglers and people running dope and get on the things that we should be doing rather than what we're doing out here.

Senator SYMMS. Was Tom Dunning at that meeting?

Mr. HOVEDEN. No; he'll be there this evening.

Senator SYMMS. Oh, good. OK. Go ahead. I'm sorry.

Mr. HOVEDEN. There was an excellent turnout of people there, however.

Senator SYMMS. Go ahead.

Mr. HOVEDEN. Looking at the tax bill, certainly it's a matter of speedup collections. We feel in many cases in agriculture it's going to discourage capital formation. Capitalization or accrual system of accounting comes along and rears its head, which becomes a very difficult thing at best, to try and keep on a farm.

So there's a cap on the cash basis of accounting at, I believe, $5 million, which you get into a large cattle feeding operation, and that's gone immediately. It will deny capital to agriculture, and we've had some horrible equity losses. And you've mentioned it earlier in the loss of land value, and what it's done to many people, it's just wiped them out. They lost their land value.

I know some people that are in that position. It certainly will handle the—the cattle feeding and many livestock forms of production because of the equity that's escaped. They have no money to borrow at the bank until they can buy feed, or they can buy cattle.

One other thing that really concerns me is the termination of soil and water expenses. I think this strikes directly at conservation and we're looking at a total new program in this country. It's called NOW. It's the North American Lake Management Society.

Senator **Symms**. It's called American what?

Mr. **Hoveden**. Lake Management Society. They had a meeting in Kansas City in May; I was there. Through the National Cattlemen, we participated. They will come again in November.

You hear that the streams and the rivers are cleaned up, but now we have to clean up our lakes. This is going to take a tremendous amount of expense. It's going to take a lot of soil conservation expenses and so forth.

As all the different environmental groups come together under that umbrella and start looking at all this stuff, is the farmer out there going to pay it all out of his own pocket? In other words, this tax bill says that you cannot deduct soil and water expenses, and certainly any conservation that you would do, as you moved to the best management practices, as we have done widely in this state through the 208 program, these fella's have spent money.

They felt, "Well, yes; I'll spend the money. I'll keep the soil from drifting down into the Snake River, and I will protect my land."

Granted, he was doing that. But it costs a lot of money to do those things.

So I'm concerned about what it would do on our soil and water expenses and conservation. We're going to see some strong demands for further environmental plans. The public is very happy to ask for that as long as they don't have to pay for it. And we're looking at the people that have to pay for some of these things.

That primarily is the main points that we would like to bring up. There will be written comments to follow, and I thank you for the opportunity.

Senator **Symms**. Thank you very much for a very concise statement, Tom.

Now, Andy, we'll hear from you.

STATEMENT OF ANDY ANDERSON ON BEHALF OF THE IDAHO PETROLEUM ASSOCIATION

Mr. **Anderson**. Thank you, Senator, for the opportunity to be here today. I represent the Idaho Petroleum Association, which is a member of the state Rocky Mountain Oil & Gas Association.

As you are well aware, Idaho is probably the only State—is the only State in that association that is not an oil-producing State, although the State of Idaho, and I'm sure the people of Idaho, would be overjoyed if some oil company was to drill a hole that had something at the bottom of it besides dust.

Although oil and gas——

Senator SYMMS. Congressman Craig would like to have you do that right up here by Cambridge. [Laughter.]

Representative CRAIG. Between Cambridge and Midvale.

Senator SYMMS. Right. Between Cambridge and Midvale.

Mr. ANDERSON. Congressman Craig might be interested to know that they have started, for the first time, seismic exploration or work in northern Idaho, above Bonners Ferry, in fact.

Senator SYMMS. In a proposed wilderness area?

Mr. ANDERSON. Yes.

Senator SYMMS. We'll get them yet. [Laughter.]

Mr. ANDERSON. That's a good place to start.

Senator SYMMS. I hope it doesn't interfere with the grizzly bears. [Laughter.]

Mr. ANDERSON. How about the wolves, as long as we're on those types of things?

Senator SYMMS. There are no wolves in the Idaho forests; there's German Shepherds, but there's no wolves.

Mr. ANDERSON. But there is a proposal to transplant them into Idaho.

Senator SYMMS. Now, remember, you're working with the oil industry now.

Mr. ANDERSON. Oh; right. Back to where I was. I have given you a prepared statement, and I see that we're probably getting into the next panel's time, and several of the things that I wanted to touch on today were already talked about.

One you brought up, Senator, and that was the intangible drilling costs.

The Rocky Mountain Oil & Gas Association and the companies we represent who range all the way from the major integrated companies to the smaller independents, are very concerned about maintaining—the President's proposal would maintain the intangible drilling costs. And we feel that's quite important because, as you brought out in your statement earlier, Senator, Idaho is considered a frontier by the Idaho companies.

And as the industry, as a whole, goes through some major changes, brought on by several things from Mr. Pickens to the drop in the cost of oil, intangible drilling costs become more important because oil companies are looking at putting most of their drilling into places that they know there is going to be something at the bottom of the hole when they get there.

Consequently, those become important to States like Idaho. If we expect to see the oil industry continue to drill in Idaho and have no hopes of Idaho becoming a producing State, intangible drilling costs are quite important to be maintained.

Senator SYMMS. Your entire statement will be part of the record.

Mr. ANDERSON. OK. The only other thing that I would bring up that is of a concern to some of the—or to all of the small independents, is the depletion allowance. They are the only—as you are probably aware, the major companies lost that opportunity several years ago and it's only afforded now to the smaller independent companies.

The independents—well, right now there are three wells that will be drilled in Idaho this year. Two of them will be drilled by an individual, and one will be by a major. If we do away with those allowances for those individuals, we'll soon see most of them cease to do any drilling at all.

And I would be happy to answer any questions, but in deference to time, I will close my statement now.

[The prepared statement of Mr. Anderson follows:]

PREPARED STATEMENT OF ANDY ANDERSON

Idaho Petroleum Association is a state division of the 8-state Rocky Mountain Oil & Gas Association (RMOGA). RMOGA represents 515 member companies which range in size from major integrated companies to the very small independent oil and gas firms.

Idaho is the only state within RMOGA which is not an oil and gas producing state. The state of Idaho would like to be an oil and gas producer. Such diversification of the state's economy through additional income from taxes, lease rentals, royalties and payroll would be extremely desirable for all the state's citizens.

Although oil and gas exploration to date has been unsuccessful in Idaho, over $80 million in the past 5 years has been spent probing the subsurface of the state in the search for hydrocarbons. The Idaho Petroleum Association believes such substantial exploration has been truly a benefit to the state and more positive results could happen at any time.

To the point of maintaining the search for oil and gas in the state of Idaho, the Association makes the following comments concerning President Reagan's tax proposals as they relate to the petroleum industry.

A change in tax law that discourages petroleum exploration would dash our hopes in Idaho in becoming an oil and gas producing state. We are concerned with any prospect for the elimination of current tax treatment of intangible drilling costs which would increase U.S. demand for imported oil from OPEC. That, in turn, would increase : (1) the price of world oil (by perhaps 6 to 9%); (2) the cost of any disruption in access to world oil; and (3) the probability of such a disruption. During the attempted oil cutoff in 1967, the United States had sufficient capacity to cover its needs; but with growing dependence on imports, the supply crises of 1973 and 1979 led to gasoline lines. Such disruptions could easily occur again -- causing a lower GNP, higher inflation and unemployment, and larger budget and trade deficits. Higher oil prices and demand for non-U.S. oil, caused by higher U.S imports, would benefit oil exporters, notably OPEC and the Soviet Union. They could induce U.S. allies that depend heavily on oil imports to pursue more self-centered foreign policies. And they could contribute to increased chaos in the Middle East.

The United States must not -- as some would suggest -- adopt a policy of discouraging domestic exploration in order to diminish import dependency by future generations. The industry cannot be turned off and on like a spigot; lead times are long (5 to 10 years or more) and skills must be maintained. We cannot say where oil reserves are without continual search; and technological advance must be pursued to enhance recovery.

Those who argue that something must be taken away from the petroleum industry to make tax reform work misunderstand two important points. First they seem to imply that unless something is taken away, the petroleum industry will not pay its fair share of taxes. Studies by the Joint Committee on Taxation have consistently shown that the industry pays income taxes significantly higher than those for the average of U.S. business. Other studies concur. The industry also pays a federal tax that is levied only on petroleum production, the Windfall Profit Tax; the industry has paid the U.S. Treasury over $67 billion through this revenue vehicle. The fact is, the President's plan would raise the petroleum industry's federal obligations higher still through the elimination of the investment tax credit, phasing out of most of the percentage depletion allowance, the plan's recapture provisions, and changes in the treatment of foreign sources income. That the President's tax plan is disproportionately favorable to the petroleum industry, then, is a misperception. The industry would pay more than its fair share of taxes under the President's plan.

Second, tax treatment of the petroleum industry cannot be tightened at zero cost to the country. More severe tax treatment would increase the country's dependence on oil imports. For example, the American Petroleum Institute estimates indicate that changing the current tax treatment of IDCs could increase oil imports by as much as 900,000 barrels per day in 1990 and 1.6 million barrels per day in 1995. Changing other features of the plan would also affect imports. Policy makers who "must take something away" should consider carefully the consequences of such actions for future energy supplies and security.

Furthermore, taking something away from the petroleum industry could impose significant costs on the nation in the form of reduced energy security. Such costs should not be allowed to result from a simple misperception. It is a fact that the petroleum industry currently pays much higher federal and state taxes than business on average. And the President's tax plan would raise those taxes still higher.

According to the data of Congress' Joint Committee on Taxation, the petroleum tax rate is 28 percent more than the average of other industries. We know of no one who challenges those figures.

Moreover, when tax payments under the so-called windfall profit tax are considered as they should be -- a tax applied uniquely to the petroleum industry and one not considered in the committee staff's calculations -- the tax rate on petroleum has been -- and is -- above that of any of the other 29 major industries studied. The average federal income tax for all industries was 18 percent, and for the petroleum industry the income plus windfall profit tax was 43 percent in the years studied by the Joint Committee -- 1980-1983.

We cannot endorse as-is any proposal which would not take these existing petroleum industry federal tax payments into account.

The President's bill is a starting point, with some positive points -- including the critically important retention of intangible drilling expenses, the lower corporate tax rates, the treatment of dividends and the indexing of depreciation. There are also serious negative points, which would discourage future investment and economic growth, including the recapture provision, the phasing out of percentage depletion for independents, the elimination of the investment tax credit and the new rules for foreign source income.

The Idaho Petroleum Association must emphasize that -- both in fairness and in the interest of our future energy supply -- Congress must recognize that the petroleum industry now pays more than its share of taxes. This country may critically need domestic oil production in a few years, and Congress' decision on tax reform could determine whether, as a Nation, we are secure or truly vulnerable.

Thank you for the opportunity to comment.

Senator Symms. Thank you very much, Mr. Anderson.

I have just one question. I have one question that I want to get back to, and it relates to the questions I was asking Mark.

And, Tom, I don't know whether you were in the room yet or not, but what I want to know is, there are some people in this state that breed both dairy cattle and beef cattle, you know, like some of the new beef varieties, the seminals and some of the other types.

They get money from some outside sources that invest in those cattle, and they grow these purebred cattle.

Now, they tell me that's critical as far as helping cattle in maintaining their competitiveness. And in this tax bill there is a portion there where the incentive for people to provide the capital for them to grow these cattle is going to be greatly reduced.

Do you have any comments on that or anything like that that I need to know?

Mr. Armstrong. I don't know on purebred beef cattle. We have some excellent breeders here, but they seem to be primarily on their own. I have not discussed that with them.

I know in the cattle feed, where we get outside money—and certainly the cash basis is a great incentive there, but if we're going to provide a market and pay for all this grain and pay for all the silage and everything we buy in the fall, we sure need some outside investors to come in.

Senator Symms. OK. Now, back to that, I want to correct what I said. I didn't mean to give the impression that Rip was in favor of accrual accounting, because he's not. What he has been trying to tell me is that I may have a hard time winning that argument, because I brought this up to Secretary Baker when he testified, and he came right back and shot back, "Well, these are hardly small operations, $5 million."

And as you say, you don't have to feed a whole lot of cattle, the way cattle are fed today, to get into the situation where you go past it. But, of course, my point is, if it's fair for somebody who makes—who has a $500,000 operation, why should there be some point—I mean, it's either fair or fair for all.

To me, accrual accounting is just an absolute—you know, it's a dream of the Treasury so they can get all the money the first year. I mean, eventually it's going to catch up with you anyway. You know, they're talking about going after accounting firms and law firms, and—you know, everybody defers income if it's on a cash basis.

Mr. Hoveden. In the long run, I think if you take Bill Richardson's case in Caldwell, he fairly well moved into an accrual deal. And when he was bought out, the taxes were paid up on it. And if you are on a cash basis and you accumulate a lot of capital there, and you want to quit, you might be looking at an awful big tax bill, so then it pays you to move over to it.

But when capital is hard to come by and capital is scarce, the equity loss that we have suffered this year—and we've seen throughout Iowa and the Midwest, the equity loss in lands—I think it's a poor time to discourage the formation of capital and new sources of capital for agriculture.

I have questioned that at times, but they have always said, "Well, you wouldn't deny that capital to agriculture, would you?"

And I haven't been able to answer that.

Senator SYMMS. Well, I have made another argument with Secretary Baker on this. I said, "One thing that they missed"—I said, "All they ought to do is come out here and go to some town meetings in Idaho" and have one farmer after another that talked to me and would tell me how they can't meet the payments of the FHA or whatever. And they're up against the wall; they're almost in tears. I mean, these are really heartbreaking stories of people that are overextended.

And if you put people on accrual basis, then you have no reason in the future to be more prudent in their management. I mean, if the farmer is out here, and he's got, let's say, $50,000 in the bank at the end of the year because he had a good strike on potatoes or something, then if he goes and buys fertilizer, buys insecticides, buys next year's seed and fuel and everything, he's going into the next year in a strong financial position because he's paid everything in advance and deducted it off on this year's income, true; but he's ready for next year.

If you put them on an accrual basis, they're going to say, "Why should I bother to buy anything because the Government is going to take some on this anyway," and they may go off and invest their money and some salesman comes by with a good scheme on how to get rich quick, and he invests money, and then the next year they're in my office crying because they're broke.

I mean, these things happen. That's the way the world works. And I just don't see the benefit. Any evidence that you come across, any of you, on why accrual accounting is wrong for agriculture, we'd appreciate having it to help us, because I think if this bill really gets to moving, this may be a hard one to win.

Mr. HOVEDEN. I can cite you quite a number of good, strong organizations that have been built on a cash basis, just for things you have cited.

Senator SYMMS. Well, absolutely. I mean, a farmer has got a lot of costs, and it just makes sense that they would invest in next year's expenses if they can. And that makes that farmer stronger for whatever he might run into: hailstorm, bad prices, you know, flood, drought, whatever may happen.

But they're in a better financial position for the next year if they've invested their profits from this year into next year's expenses. And they're much stronger financially. And eventually, if they keep making a profit, the Government is going to get their money anyway. If the Government is so broke because of all the prolific expenders that they want to go out here and squeeze the blood out of a turnip to get the money, and that's what motivates about half of this harassment from the IRS and these hairbrained ideas that came out of the Treasury, is because Congress won't shut off the faucet.

If we'd stop spending all the money and we had a surplus, well, then, all of a sudden they'd stop harassing everybody and coming up with these kinds of schemes.

See, what they do is go through there and just look for ways to find more money, and any place they can find it.

Thank you all very much. I appreciate your testimony. It was excellent.

Mr. ARMSTRONG. Thank you.

[Whereupon, the panel members were excused.]

Senator SYMMS. The next witnesses will be Rick Van Hemert, Idaho Association of School Administrators; Steve Shaw for Northwest Nazarene College; and Mildred Howard of the Idaho Council of Senior Citizens.

[Whereupon, the panel members assembled.]

Senator SYMMS. You're Steve Shaw? Is that right?

Mr. SHAW. Yes.

Senator SYMMS. Steve, you go right ahead. I'm going to step out of the room for a second, but I'll be right back. And Congressman Craig will carry on the hearing.

Please commence. Welcome to the committee.

STATEMENT OF STEPHEN K. SHAW, CHAIRMAN, DEPARTMENT OF POLITICAL SCIENCE, NORTHWEST NAZARENE COLLEGE

Mr. SHAW. Thank you. I just have some brief comments here that I have prepared. It will be easy to keep them concise, given my expertise in this affair.

But Dr. Gordon Wetmore, who is the president of Northwest Nazarene College, Congressman Craig, was committed to a prior engagement today and asked me to be his absentia appointment at this meeting.

In this respect, I come here as merely the institutional representative for NNC and not as any kind of expert on fiscal or monetary matters.

As you are well aware, Canyon County is home to two well-known private institutions of higher learning. Northwest Nazarene College and the College of Idaho are each recognized for their academic prowess, their highly trained professors, and highly educated alums and students, including Rhodes Scholars and other proud and deserving award recipients.

The Frenchman, Alexis de Tocqueville, wrote that self-interest rightly understood is the basic American creed. We, at NNC, applaud President Reagan for attempting to inject fairness and simplicity into the Federal Tax Code.

Dr. Albert Einstein once said that politics is more difficult than physics. I think perhaps he had in mind our tax system with its Rube Goldberg-like qualities.

Usually we take the approach toward taxes once mentioned by a senior Senator from my native state of Louisiana, Senator Russell Long, who said our approach is: "Don't tax him, don't tax me, tax the fellow behind the tree."

Obviously, NNC doesn't want to appear selfish or evade its role in helping the Nation address this pressing problem, especially since we are an ethical, religious institution.

However, since we are one of the principal educational institutions in this area, and one of its primary employers as well, we believe that the potential adverse impacts of some of the administration's tax-reform proposals should be scrutinized closely.

Under the President's plan, those individuals who do not file an itemized tax return would be unable to take their deductions for their charitable contributions. What this would—according to the

Chronicle of Higher Education, a study produced by a group called Independent Sector, what this would result in would be roughly a $6.8 billion shortfall in charitable contributions given to higher education in the United States in the next year, both public and private institutions.

Beyond these types of charitable contributions and their potential problem of their being affected by the inability of some to deduct if they don't itemize, we also have—as does virtually every other educational institution in this country—we have alums and others who give NNC revenues and stocks and bonds and real estate.

These could be affected as well by the proposed rules governing appreciated property, for example. I don't pretend to understand the complex formula where that appreciated property quotient would go into the tax that one would pay. But as it stands now, the proposal governing appreciated property would become law, and that would result in a $4.2 billion shortfall for higher education in the United States.

So with that other $6.8 billion figure and this $4.2 billion figure, higher education would see an $11 billion shortfall next year.

What this would result in is a 23-percent dropoff in total financial support that higher education receives now. And this is somewhat of an improvement over the Treasury I proposal. That would result in a 27-percent dropoff in total givings to higher education.

So while it's an improvement, we think it's still a troubling reality—or it would become reality.

Closer to home, the health of NNC depends to a large extent obviously on a healthy economy, both here in the State and in the northwest. In turn, the health of the State of Idaho hinges greatly on the health of her colleges and universities, both public and private.

NNC has loyal alumni and retains a close affiliation with its parent religious denomination. However, NNC and colleges like her cannot afford to see investments and contributions merely stay steady. Sources of income have to improve and increase to meet new challenges as we move into the 21st century.

Now, another matter besides the charitable contributions and appreciated property as I understand it now—and I may be mistaken, so if I am, please correct me. But as I understand it now, the tuition tax benefits—or not tuition tax, but credits, for example, that NNC provides to its employees, both faculty and staff, under the current proposal put out by the administration, that would remain in the law and would retain its tax-free status, and obviously we'd like to see that stay because we think it's a wise course for a small private institution like NNC with a relatively meager salary base for faculty and staff to be able to provide its employees tuition benefits for their dependents. So we hope that that can stay on board and won't be washed away.

In conclusion, Senator Symms and Congressman Craig, we at NNC thank you and your staff for this opportunity to air our views, meager as they are, on tax reform, and obviously wish you well in your future deliberations.

I know every benefit seems like a good one, and we know that being a private religious institution, we have a particularly—especially given current or recent Supreme Court rulings, a ticklish matter with respect to church-state relations, but when it comes to charitable contributions, of all the groups that receive such contributions, higher education is probably the one that potentially would suffer the most under the administration's proposal.

So we'd like to urge that charitable contributions, itemized and nonitemized returns, be allowed to be deducted, and that the appreciated property proposal be studied closely, and as well as even the maximum tax rate, making a deduction perhaps less valuable as that may become law.

And then the tuition waiver that I mentioned a moment ago, because obviously I'd like to see that stay, too.

Senator **Symms**. Before we get with Mrs. Howard's testimony, let me ask you one question about—I mentioned earlier here—I don't know whether you were in the room, and I'm sorry; I wasn't in the room when you mentioned my dear friend Russell Long's: "Don't tax him, don't tax me, tax the fellow behind the tree," because that has been the—that is the marching drum beat of all Americans.

Mr. **Shaw**. Sure.

Senator **Symms**. And I guess we can at least be proud that people in this country have an incentive to try to enjoy some of the benefits of their labor, and that part of it is good. But the Hall-Rabushka tax plan which Senator DeConcini of Arizona has introduced—and I have cosponsored it with him, to give it a Republican sponsor on the committee—does away with the deduction on charitable donations. And Hall and Rabushka, the two economists at the Hoover Institute who, in fact, earn their living from tax-free donations, maintain that if the tax rate were low enough, like down to 19 percent or possibly even lower, but 20 percent or lower, that it would still be adequate, because then you're talking about a 19-percent dollar instead of a 50-percent dollar for contributions as it is today, because a lot of people who contribute are in the 25- to 50-percent bracket, that there would still be adequate contributions to support private institutions and churches and so forth.

What's your view on that?

Mr. **Shaw**. As I mentioned earlier, I'm just a political scientist, I don't understand an awful lot about economics and taxation. And if you know anything about——

Senator **Symms**. Don't feel bashful about that because there's a whole bunch of political scientists in Washington that don't know anything about economics, but they pass laws on it every day. [Laughter.]

Mr. **Shaw**. I spoke to some of my students about that too, by the way.

But I suppose my basic response, Senator, would be that each institution obviously is different. And with our close affiliation with the Nazarene Church, we get obviously a large source of our revenue from the Church of the Nazarene in States like Alaska, Colorado, Idaho, Washington, Oregon, Wyoming, and Montana, principally, including Utah and some parts of California.

And last year, I believe, the total we received in church-giving came to about $1.2 or $1.3 million.

The amount that we received from individuals in terms of donations for a variety of causes, whether it be a scholarship or just to general funds for operating budget, probably came to around only a fourth of that amount.

Obviously, we'd like to see that improve so that individuals give more.

We do have, as I mentioned before, the—the loyal alumni who for the first time this past year gave contributions that totaled into the six figures, but that's the first time it has happened in the school's history.

But because we depend to a large extent on the church-giving, if we see a drop in the individuals' giving, it doesn't have quite the impact that another institution might encounter.

But in terms of the tax break and the tax rate, I honestly haven't studied that enough to know just what the effects would be.

I do know that the bulk of giving to NNC from individuals, I think I would be safe in saying, comes from small amounts from those in the lower to middle income tax brackets.

The majority of our students in the roughly 1,000-student college, the majority of our students come from, I'd say, lower and middle income families who possess an awful lot of loyalty to the school, and we see amounts—I was looking at a spread sheet just the other day, and we see amounts in, you know, $50 and $100. We don't seem to find too many $5,000 and $10,000. So I'm not sure how that would be, especially given our institution reality.

Senator SYMMS. OK. Thank you very much.

Before Mrs. Howard, I'm going to go back here so we can kind of keep our education record in order. And then we'll come to you, if you don't mind waiting.

Rick, we welcome you to the committee this morning, Rick Van Hemert, Idaho Association of School Administrators.

And we welcome you here, and we'd like to hear what you have to say about this.

Mr. VAN HEMERT. Thank you, Senator.

STATEMENT OF RICK VAN HEMERT, EXECUTIVE DIRECTOR, IDAHO ASSOCIATION OF SCHOOL ADMINISTRATORS

Mr. VAN HEMERT. It's a pleasure to be able to speak before such an august body. I thank you for that.

I am the executive director of the Idaho Association of School Administrators, and that's a professional organization of about 560 public school administrators, superintendents, elementary principals, secondary principals, administrators of special education programs. And we represent probably 75 percent of all administrators in public education in the State.

Virtually every school district in Idaho has at least one or more members in the administration.

I'm here to urge you to retain the deductibility of State and local taxes and any tax reform proposal that you might vote on in Congress in the near future, particularly anything to do with property taxes.

The Reagan administration—and I believe rightly so—has said that education is the responsibility of the State and local governments. I believe that to be the proper place for education.

You must understand that public education in Idaho and virtually across the Nation is supported by State and local taxes of one sort or another, including the State income tax in Idaho, State sales tax, and local property taxes.

I'm sure you've heard before that no tax is popular. That is certainly true in Idaho.

But deductibility of those taxes makes the tax more palatable to the public that has to support public education for those tax measures.

The removal of deductibility makes public education funding much more difficult in this State; particularly at the State and local levels, since no direct tangible payoff to the taxpayer would be evidenced if you were to remove that deductibility.

I would draw your attention again to deductibility of property taxes on income tax forms. Of all the taxes in Idaho, property tax is probably the most unpopular, as I'm sure you are aware, as evidenced by the 1 percent initiative which was passed in the late 1970's, and the 50-50 homeowner's exemption which was passed in the early 1980's.

However, the property tax is virtually the only available way for local school districts to do several things that they cannot do necessarily with State dollars.

One, if they want to supplement their instructional program, they have to go to the local property tax owner and ask for an override election or a supplement levy election as it's technically called.

Two, they want to build new schools for their increasing school age population. The only source of revenue that they have is the local property tax. And in Idaho the school population is increasing by about 1 to 2 percent per year, and it's projected to continue to increase at least to the next decade.

Three, the property tax is the only method available to school districts to renovate existing, outdated, or antiquated buildings for safety, health, or instructional purposes.

School districts in Idaho, as reported to me, that it's becoming increasingly more difficult for them to pass any kind of property tax measure to do one of the three things I just stated, because of the lag in the economy in the State and, again, the unpopularity of the property tax.

The loss of the deductibility of the property tax and other State and local taxes will increase the opposition to efforts by school districts to improve their instructional settings and seriously delay the needed improvement.

Up to that point, school districts have sort of robbed their capital expenditure funds in order to supplement their instructional programs. But they can no longer rob anyplace because all the funds are used up, and there is no other place for them to turn.

As a result, capital improvements to school buildings have been delayed and delayed and delayed until at this point they cannot delay any longer, and they must go and seek funds to do that.

Good public schools are an asset to the Idaho economy. That has been demonstrated over and over again. When businesses look to locate in the State, they want to know what the educational system is like, and if we can demonstrate a good, sound financial system that undergirds a good, sound instructional system, then those companies are either going to stay in Idaho or are going to relocate.

Every effort should be made to strengthen the financial underpinnings of public education, and you should abandon efforts which would weaken the physical integrity of the public education system in this State.

Thank you.

Senator SYMMS. Thank you very much.

I just was handed a sheet here. It says that the distribution of the deductibility after-tax value among the States per capita—this is 1982, and back to your point about the deductibility—per capita to taxpayers of New York State is worth $231, and to Idaho it's worth $65. So there is an argument—and you have missed some of the testimony earlier here—about that point that maybe that's one tax deduction, some people are saying, that if we gave it up, the net effect would be that most of it goes to eight other States. And that's one side of the argument.

The other side of the argument—your argument is not based on this reason, but any tax preference that's carried with any piece of property, whether it be capital gains treatment on a stand of forest out here in the woods, whether it's depletion allowances on a mine that's over here in Silver City or somewhere, or whether it's a tax deduction on the property taxes on a house in Boise, that is a value that goes with the property. And if you take that away, you probably—this question may not be the right question to ask you, but I wonder if in a long term, if it has any negative value on people being willing to invest in real estate.

If somebody invests in real estate, at least they're getting the tax deduction on the property taxes today. If they didn't get the tax deduction, they might just decide they'd rather invest in Treasury bonds or something. Maybe they wouldn't.

Do you see what I'm saying?

Mr. VAN HEMERT. I understand what you're saying; right.

Senator SYMMS. But I think that that other question from you as a school administrator, you might take a look at that. There may be other things in the Tax Codes. We may get into a situation where there is going to be a tax bill passed one way or the other. I mean, if the votes get piled up in Congress, the momentum gets going nationally, and they're going to pass tax reform, then Congressman Craig and I may have a choice to say, "Well, we can't get all of this protected."

But which ones of these things are the most important for the jobs, the economic viability of Idaho, which indirectly is in support of the public school system—which directly is in support of the public school system, I should say.

And you might look at that. Which would you think was more important, really, if it comes down to the choice time and you can have two or three of these things, but you can't have it all because of revenue neutrality?

I would ask you to take a careful look at that. I mean, I'm not—I appreciate your statement and your testimony, and I have always thought that I took your position.

Now, in a choice, if I have to start choosing between five or six of these tax preferences that are in the code, whether that's that important to Idaho, I don't know. But looking at it from that standpoint, and if you have any more thoughts on it, I'd be very interested in your input on it.

Mr. VAN HEMERT. Well, in response right now, I hope you don't have to make those choices.

Senator SYMMS. You'd just rather not have the bill in?

Mr. VAN HEMERT. I wouldn't say the whole bill, but in certain portions. Again, the financial strength of the public education in this State has relied on three taxes: personal income tax, sales tax, and property tax. And all three are necessary. They need to stay in place in order to, again, maintain the integrity of the system.

If we lop one off, it simply puts more pressure on the other two, and the backlash that we're seeing, say, on the property tax could easily be transferred to the other taxes, and we're in exactly the same boat we were before.

Senator SYMMS. So the people would still be paying anyway.

Mr. VAN HEMERT. Right.

Senator SYMMS. We'll let Rip ask—we'll get to you in just a minute, Mrs. Howard.

Rip's got a question he wants to ask this witness.

Mr. RIPLEY. Well, everybody seems to say that they're in favor of this tax bill. And probably the most important thing is the lowering of the rates.

My question is, that this is one of the major fund raisers in the President's bill. It raises some $37 billion.

Now, my question, which I heard the chairman, Senator Packwood, ask many times. If you don't want this, which would raise $37 billion primarily to go to rate reduction, where would you raise this money? What would you do if you don't want to—am I making it clear?

Senator SYMMS. Yes; what he is saying is that by taking away the deduction of State and local taxes, the administration raises $37 billion in revenue. Then they turn around and reduce the tax rates on individuals and corporate tax rates. That's one of the major things in the bill.

So Rip's question is: If you don't have that $37 billion, who do you want to go to to raise $37 billion from, back to what Steve Shaw's talking about, "Don't tax him, don't tax me, tax the fellow behind the tree." Which fellow are we going to get?

Mr. VAN HEMERT. Senator, I guess I'm not in a position to tell you what that is. My interest is in protecting the interests of public education, and if that means placing a burden on somebody else, then so be it. I'm just not in the position to tell you where to go. I'm not privy to all the information that you have.

All I know is what the impact would be on public education. And I consider that to be a top priority.

Senator SYMMS. Well, I think that's fine. You don't have to answer it.

Rip, I thank you for bringing it up. Having the question asked is the main point. That's the dilemma of this whole exercise that we're going through right there in a nutshell.

I think Congressman Craig has a question.

Representative **Craig**. More of a comment, Rick. I think that the National School Boards Association—National School Administrators Association were very quick to react, if not too quick to react, when the proposal originally came out. The moment that they saw the nondeductibility, they immediately reacted without doing an economic analysis of the impact. And I think Rip has put it very clearly.

Rate reduction in Idaho to Idaho taxpayers probably, in the long term, if not the short term—and I know in discussions with the State superintendent of public instruction here and some analyses that are currently going on, and I can't prejudge those analyses, but I put the question to Jerry Evans: Go find out whether rate reduction is more valuable than a $65 net savings to the average taxpayer in the State of Idaho.

He hasn't come back with that question yet, but the problem we're getting into, and I think that Tom Stivers, speaker of the house, said it very well this morning, the net benefit to Idaho in deductibility is $65. Why not per person, tax-paying person, why not go to New York where it's $231?

The bottom line is, I do not believe Idaho schools are hurt. From my cursory analysis of this, by the deductibility versus the nondeductibility, I think it is a reaction because you are using—you have so historically been in that mode. And I think when you see the Idaho taxpayer really is the net beneficiary of it, my guess is, your position will soften some at the national level.

Mr. **Van Hemert**. May I respond?

Representative **Craig**. Certainly.

Senator **Symms**. Go ahead and respond.

We're going to get to you, Mrs. Howard. Just be patient.

Mrs. **Howard**. I'm here for the day.

Mr. **Van Hemert**. I don't want to steal this good lady's time.

I understand what you're saying, Congressman Craig. Perhaps the net benefit will be $65 in every person's pocket. Our concern is this, and it goes back to my earlier comment, that in this State people are so engrained in the present tax system and tax structure, that no matter what the benefit may be in terms of personal tax gain, the fact that they can no longer deduct some of those taxes off of their personal or corporate income tax will still generate extreme opposition to anything that the local school district may do to tap into the local property tax base for increased revenues.

You know, in theory—and probably in reality—what you're saying is correct. But politically, I think it would——

Representative **Craig**. You also argue perceptually.

Mr. **Van Hemert**. Right; perceptually, it would still be there.

Representative **Craig**. That's probably very right.

Senator **Symms**. Well, you know, Congressman Craig may not even realize that along last spring about the time that the Treasury Department came out—or last fall, with Treasury I, which I thought was an absolute disgrace to a Republic administration to suggest such a crazy tax bill—it had every tax idea that everybody over at Treasury had had for the last 30 years of how to squeeze more blood out of the private sector.

I sponsored a bill to not allow the deductibility of, you know, what you're talking about. There's about 10 or 15 Senators on the bill.

Now, as I look at that, in context of this new proposal and the whole situation, I have kind of softened my position a little bit. But as Mr. Ripley points out, without this in the tax bill, in tax reform, there probably won't be any tax reform.

So the way I'd kind of like to have this play out in the Senate Finance Committee is to have this be the last issue decided. And I'll see how far we've gone on everything else. And if we have been treated poorly up to this point, that might depend on how this Senator would look at this issue.

Now, you know, in theory, I think that Larry's question is one I want to get answered, where we are in Idaho. And I'd like to have you look at that again. And I think there is a point—I think some of us may have jumped on this sooner than we should have, but under the context of the time I cosponsored the bill, I think it was still all right. I don't feel bad about cosponsoring it, because I just think that they had destroyed every incentive for anybody to do anything at the State and local level, or to do any investing in anything that might provide jobs in Idaho on the first bill.

And this second bill is a big improvement. But it still needs a lot of improving, in my opinion, before it ought to ever become law.

Mrs. Howard, we welcome you to the committee. We'll stop talking about education and——

Mrs. Howard. That's one of my favorite subjects, is education.

Senator Symms. We'll hear from Mrs. Mildred Howard of the Idaho Council of Senior Citizens.

STATEMENT OF MILDRED HOWARD, PRESIDENT, IDAHO COUNCIL OF SENIOR CITIZENS

Mrs. Howard. Congressman Craig and Senator Symms, it's a privilege to be here. And not only do I want to represent the Idaho State Council of Senior Citizens, but I would like to represent my family, four generations of working people.

I am still working 5 days a week. I'm still paying Social Security in, and I'm receiving it. So I'm getting both ends of the bargain.

And my children are all in their fifties. They're all working. One is a logger and one is a teacher. So you know what their incomes are.

And I have 12 grandchildren from 36 to 14. I have 14 great grandchildren that are from 1 week to 16 years. Those are not yet in the labor market.

But the rest of my family are. I am the head of the family and, therefore, I favor this tax bill very much.

Most senior citizens, and most other taxpayers, would be treated more fairly with the tax reform plan of the Reagan administration. They would also be better off with other tax reform proposals, including the Bradley-Gephardt plan, and the Kemp-Kasten plan.

The benefits of the reform include:

The existing system taxes salary income most heavily—while giving breaks and writeoffs to many other kinds of income. This would be partly corrected by the Reagan or the other major tax reform plans.

The existing plan is complicated. It is difficult for many people, including many senior citizens, to prepare the tax returns. The reform plans are simpler. Fewer people would have to itemize their deductions.

The existing tax system taxes poverty. People who can barely pay the cost of housing, utilities, and food are taxed on their income. The Reagan proposal would double the personal exemption to $2,000. This would be helpful to seniors.

People who have not reached retirement age now pay withholding tax for Social Security, plus income tax on their salaries. The Reagan plan would allow a family of four to pay no income tax on the first $12,000 of income. This would ease the burden of the Social Security withholding tax.

By spreading the tax burden more, to pick up some of the nonsalary income that now escapes taxation, the reform plans would make Social Security withholding less burdensome.

Published data indicate that most individuals would pay less, at all income levels. The Reagan tax plan, however, is tilted to give a disproportionate tax reduction for the highest incomes. This can be corrected without sacrificing the basic goal of simplification.

With the Reagan or other reform plans, most seniors, and most Americans, would pay less tax. They would pay less because the minority which now enjoys the greatest benefit of credits, writeoffs, and exemptions would no longer escape paying a fair share.

The unfairness of the existing tax system is an insult to everyone. Tax reform is long overdue.

Senator SYMMS. Thank you very much, Mrs. Howard, for a very direct and excellent statement.

Representative Craig.

Representative CRAIG. Mildred, thank you very much. Of course, that is exactly what we are attempting in part, and that's the whole premise that has driven the concept of tax reform. And I was pleased to see you go beyond just the Reagan proposal, to bring in Kemp-Kasten and Bradley-Gephardt. There are others.

Mrs. HOWARD. Yes.

Representative CRAIG. And I think that the Senator mentioned earlier—and it was my concern when the proposal from the administration came out, that we're really failing to miss an opportunity to simplify and maybe lower some of the rates by having brought in the whole basket of tax law. And that's part of our problem right now in attempting to deal with this.

Average working men and women in this country today are paying the burden.

Mrs. HOWARD. Yes.

Representative CRAIG. They're basically financing government in large portion. There's no question that that's where the largest amount of money is. And that's something that we oftentimes fail to recognize.

I notice that oftentimes quoted Peter Graces' Commission report said if you tax all—took all of the money, that—what was it, 100,000 plus?

Senator SYMMS. Seventy-five.

Representative **Craig**. 75,000.

Senator **Symms**. Confiscate everybody's income above 75,000.

Representative **Craig**. We could run government for maybe a couple of weeks, max. So there is no question that we have to go where the money is if you're going to tax.

But I do think that the driving thrust of all of the proposals is going to be toward fairness and simplification. And we have to balance it out so that average working men and women out there are less——

Mrs. **Howard**. We're the ones that are hurting, really. The budget should be balanced. There is no doubt of that, because my great great grandchildren are going to have a terrible time if it is not balanced.

Senator **Symms**. I think it's going to take that long.

Mrs. **Howard**. I feel like it should be balanced more equally among all the people in the United States because we are a Nation of all people, rather than on just the laboring class.

Representative **Craig**. Thank you.

Senator **Symms**. Thank you all very much. We appreciate your testimony.

[Whereupon, the panel members were excused.]

Senator **Symms**. We will take a break, and while the panel is coming up, we'll allow the court reporter to refill her machine.

[Whereupon, a short recess was taken.]

Senator **Symms**. We'll call up the next panel: Tim Brennan of the Idaho Retailers Association; Don McMannis, Food Marketing Institute; Dennis Shaver, Shaver's Markets.

[Whereupon, a discussion was held off the record.]

Senator **Symms**. I guess the next panel, if Tim Brennan, Don McMannis, and Dennis Shaver aren't here, we'll skip over them. And the next panel are the individuals from the private sector: Mr. Duane Williams, Mr. Stan Gilbertson, Mr. Bert L. Robinett, Mr. John Connors, Mr. Dave Hague, and Mr. Ralph Smeed.

Just please come up to the panel, gentleman.

[Whereupon, the panel members assembled.]

Senator **Symms**. And I want to thank Congressman Craig for his participation in this hearing today. We welcome his input and his comments.

I have welcomed the input from the senior Senator, Senator McClure, through the process and have kept in very close contact with him about my perception, about how this tax bill affects his people in the State of Idaho.

I see that some of the panel just showed up. We just called up the next panel, Tim, so we'll have you right after this group.

So let's go right down the list.

Larry Craig has got to go. Larry, we thank you very much.

Representative **Craig**. Let me thank you for giving me a chance to participate. I have a 1:30 appointment, but I'm having to take some of the selected testimony that has come from your three hearings that I think are well founded for a resource state like Idaho and the impact that the proposed tax plan currently has prior to markup and hearing and submit it to the House Ways and Means.

And thank you for creating the forum and collecting this type of information. It's critically important to know.

Senator **Symms.** OK; thank you very much.

OK; the first witness here will be Mr. Duane Williams.

Duane, welcome to the committee.

Mr. **Williams.** OK.

Senator **Symms.** Pull that microphone over there so we can hear you.

Mr. **Williams.** This one here?

Senator **Symms.** Right.

STATEMENT OF DUANE WILLIAMS, FARMER

Mr. **Williams.** I am probably about the most amateur testimony giver here today, but I do my own taxes.

Senator **Symms.** We haven't heard from all of them yet.

Mr. **Williams.** I do my own taxes, and I spend over a month a year plowing through the regulations and trying to figure it out. And at the end of the month—end of February, or end of January, I'm an expert for a little while; I forget all this stuff.

But I have a lot of opinions on it because I do my own taxes. And then I have a man come in and check them. I pay him to show me where I did it wrong.

But as a farmer and an investor, last year I had 10 different schedules to fill out for the Federal, plus my 1090's, W-2's, W-3's, 1096's and all that good stuff that is on a one-man farm operation, and one helper, my son, I get into about 15 different forms I have to fill out.

So when they start talking politically about tax reforms and simplifications, it sounds real good. But when they changed it the last time in 1981 and they changed the depreciation schedule to the ACRS and I had to spend 2 weeks reading the propaganda and trying to figure out what they were trying to do, I don't call that a simplification.

I now have to keep two separate depreciation schedules: One before 1981, and one after 1981. And there is no way to whip it. You've got to join them. You've got to do it the way they want you to do it. And it just doubled my work, as I'm sure you are aware, but that's not simplification.

And when we start talking about tax reform, I mean, we need it bad. There's a tax revolt in this country right now. There is an undercurrent. There's people that are middle class. They were the taxpayers of this country since World War II, and they have had a bellyful of the spending in Washington. They see their dollars being thrown away or given away, and more and more government programs.

And they think to themselves—now, this isn't me. I'm too damned chicken. I'm afraid to go to jail. I pay every nickel that's due. But there's a lot of people that just have a bellyful. And they just do not intend to spend any more than they can get around spending. And if you want people to pay their taxes, you're going to have to treat them right and treat them fair. And any reform should be truly a fair reform, not for special interest, as it has been in the past.

The reason we've got so damned many forms is, one group will get into the Government and they will pass a special interest law.

The next group gets in and says, "Hey, that's a windfall. Like the alternate minimum, we're going to slap a tax on that because they took those tax credits over there, they took this or that that we said they could take, but now we're going to penalize them so we'll take them for taking the thing."

So you fill out two forms instead of one. I mean, this thing—what we need to do is go back to about 1950, take the 1950 form or someplace in there, and just start all over again and leave off all this stuff they have added on. Because when we start talking about all these good changes here, there are things in there—I'm going to take the Reagan one because that's the only one I even paid any attention to—there are things in there that were in there for a reason, to try and make it more fair.

Now there are things in there that are for special interest, like, maybe business meals. Well, hell, a business meal that costs five bucks is one thing; a business meal that costs $500 is another thing. There is no question about that.

But there has still got to be a true and honest line in there someplace. But the ones that really irritate me, the biggest irritant I have got is the capital gains. That thing is a tax on savings which the Government tried to encourage on the one hand. And then they came along and passed alternate minimum, saying, "Hey, you're getting a windfall so we're going to penalize you if you did too good at it this year. You can't go back and income average it."

The income average is one of the most fair forms that ever came along because a lot of people will work maybe 5 years at a loss and then have 1 decent year, and all of a sudden they've got 5 years of income and they get stuck on the whole thing, especially if it's in a capital gain.

But the capital gain thing that needs to be changed, mainly, is to put it on a true, prorated basis. Right now, if you keep something six months, you get the same tax break as if you keep it 60 years.

You have had a family, say, or a family business and you've had it—you don't really have any cost in it, so you get ready to sell it and, by gosh, you've made a tremendous amount of money. But that's not a true income.

What it is, is a tax on inflation. The Government spends more money than they have got. They can't pay their bills. So they inflate the dollars so they can pay back their interest on this money. And then they come along and they say, "Well, gee, you're selling that piece of property you've had for 10 years. You have doubled the price."

They don't mention the fact your dollar is only worth half as much, but they're still going to charge you the tax.

Gee, they charge you only 20, 25 percent. That's a big break. They shouldn't be charging you any tax except on the true gain. This capital gain should be on a prorated basis allowing for inflation. And you should not be treating a 6-month gain the same as an unlimited amount of time gain. It should be prorated out.

The other thing that irritates me about this whole thing—one of the other things, is that I feel it is a sham, as they say; well, you can only pay interest on your first house.

Well, what if you had a mother and a father, and you bought a house for them to keep them out of the nursing home? Why shouldn't you be able to deduct the interest on that second house?

If you're going to charge a man for making interest on his money, if he goes out in the marketplace and puts it in the bank and is making 8 percent and he's over here, he's got a second house and he's paying 13 percent, he's got a 3-percent loss any way you look at it. And if he's going to be charged tax on his interest, he should be able to deduct his interest.

I don't care if it's his 14th house or he doesn't even have a home and he lives in an apartment; interest is interest.

The same with deductions on some of these other deductions. If you have got a State tax and a local property tax, as far as I'm concerned, there is no way you should be charged a double tax. I don't give a damn if they have a 100-percent tax in the State of New York. It should be deductible.

And if we don't have any State income tax in the State of Oregon, or whatever, that's Oregon's problem. They'll get around to it. If there's a tax break, they'll sure as heck find it, and they'll get it from that end.

But it should be completely fair. If you're going to charge on one side, you've got to give on the other side. And it shouldn't be any more of this special interest stuff, that they've got the biggest lobby in the country, so they get the special tax breaks.

Senator Symms. Mr. Williams, let me ask you a question on that point. I have long contended that the way to get to tax reform is to step clear across the river, if you want to do it, or else just start reducing the rates gradually and let this thing phase in over a 10-year period. You could do it either way.

Do you think if you started on the basis that you're going to remove the bias against savings, that you wouldn't have all this necessity for these things?

What you've just stated is a very good case of why we have things in the tax code to mitigate savings by ACRS or all of these things that you're talking about, capital gains; everything came from a reason.

Do you think that would be a good place to start, or do you think that's too ambitious, that we could never do it?

Mr. Williams. To do what again, now?

Senator Symms. Well, if you took away the deduction for interest and took away the double taxation on dividends and interest, then you'd be at a starting point where you could get rid of all these deductions.

Mr. Williams. That's true. If you're going to have one, though, you have got to have the other to be fair.

I mean, if we do like the Japanese do and we don't charge them on interest on savings, well, certainly they shouldn't get a deduction for it.

But what's going to happen, this thing here is so silly, on the second house. That's just going to create paperwork unlimited.

Senator Symms. Well, you'll just get the mortgage on the first house.

Mr. Williams. Sure. Right.

Senator Symms. And spend enough to pay for the second house.

Mr. WILLIAMS. Right.

Senator SYMMS. Let me ask you another question, and then I want to go on to the next witness.

You said at the outset that people have had a bellyful of Washington, DC, continuing to tax and spend.

If Washington, DC—the Congress—would pass a budget which would be what we would call a commonsense budget which would reduce spending down to income, do you think you'd have all this harassment going on now—you, as a taxpayer, do you think all of these ideas would have been thought up and these complications would have ever come along if there was no big pressure on the deficit?

Mr. WILLIAMS. Well, I think regardless if they had the deficit, this thing needs to be simplified and trued up. And I mean true true.

They can have a 1-page form, but if you've got 95 pages of worksheets and instructions that goes with it, that's not simplification. You haven't gained anything. That's what most of the simplification is that comes out. It's really not true simplification.

Senator SYMMS. Well, thank you very much. I appreciate your testimony.

Mr. Gilbertson.

STATEMENT OF STAN GILBERTSON, RETIRED BUSINESSMAN

Mr. GILBERTSON. I am Stan Gilbertson, a retired businessman. I'm limiting my remarks to income tax.

Now, I'm not going to say I'm for the Reagan tax, but I'm going to say I'm against the Reagan tax because: The recent trends in tax reforms are disturbing. Since most citizens seem ignorant of the principles of taxation, there is a chance that mistakes will be made that will be costly to all people and result in a reaction that may cause a regression to a one-party system such as we had back in the 1930's and 1940's.

Here is an illustration of what has happened so far under the present administration in tax changes. This red line shows the tax of 1981, which got out of date because of inflation.

The purple line shows Reagan's 1984 tax. And the brown line shows the present proposal. And as you can see, the difference in the early years is not great, but the difference in the later—in the higher incomes is considerable.

And your last graph over on the end of the wall there shows the same thing. People with incomes of over $200,000 a year or one-fifth of a million dollars, they get a tax break. And it's the same thing that shows on this graph.

President Reagan says in his tax speech that under the new system, that now people could become wealthy and that we should go for it. This is absolutely true. The wealthy can indeed become more wealthy by having a total of nearly 50 percent cut in taxes from the 1981 rate for those whose incomes exceed $1 million a year.

In 3 years, the savings in taxes will exceed $1 million for such a person.

So we want an economic system where the rich become richer and the poor become poorer? Examine the nations of the world and see the nations where there is a great spread between the extremely wealthy and extremely poor, and you will find nations where the economic discontent runs high and communism runs rampant.

A better solution to the problem of tax change and simplification is a bracketless tax whereby the transition between income brackets is smooth and uniform. If the authorities insist on a percentage range between 15 and 35 percent, why go about it with sudden jumps of 10 percent between brackets. Don't they have mathematicians in Washington?

If they want a smooth transition between 15 and 35 percent, all they have to do to accomplish the same thing is take a factor, and they can take a factor of 0.00825 per thousand above the 15 percent, and they'll accomplish roughly the same thing. It's simple and a lot more fair and gives a smooth transfer from 15 to 35 percent. This would discourage cheating to achieve a lower bracket.

Who wants to pay that extra 10 percent all of a sudden? Let's make taxes fair and as painless as possible.

The best way to set income taxes where all people pay their fair share of taxes and tax burdens become equalized is a straight bracketless tax. A person with a net taxable income after deductions of $1,000 should pay the same burden of tax as a person with an income of $1 million.

The poor should pay the same tax—pay some tax to let them know that Government costs money and that any rise in Government spending will take a bite out of everybody's pocketbook.

The only way to achieve this is with a bracketless tax. A flat 15 percent tax on a person with a net taxable income of $1,000 after deductions is excessive. A tax of 35 percent on a person with an income of over $1 million is no burden at all. A simple bracketless tax would place the burden of taxation evenly.

A person with a net taxable income of $1,000 should pay the same proportional tax as one with an income of $1 million but not the same percentage. A straight progressive, bracketless tax will accomplish this very easily and simply.

The bracketless tax idea in taxation lends itself to an infinite variety of variations. The key percentage used in my illustration—and I'll give it to you afterwards if you want to use it—is 0.005 percent times the net taxable income after deductions rounded to the nearest thousand.

For example, a net taxable income of $34,285 would be 34, which is the nearest number of thousands times 0.005 percent, and that equals 17 percent, which is the tax percentage. Seventeen percent times the net taxable income of $34,285 would give you the tax due.

This tax helps those in the lower, the middle and all income brackets and gives an equivalent burden of taxes on those in the higher income brackets. This form of tax is even more simple to figure than the old-fashioned bracketed tax and is far more fair and equitable. A fifth grader could figure his dad's income tax under this system if he knew the net taxable income.

This tax is also keyed to inflation and deflation as it is based on the national average individual annual income and it, therefore, would never become out of date. As the cost of living and incomes go up and down, the tax moves proportionately with the change.

That's all I have.

[The prepared statement of Mr. Gilbertson, together with attachments, follows:]

PREPARED STATEMENT OF STAN GILBERTSON

I am Stan Gilbertson, a retired businessman with a University degree (B of A) in economics. I have also taken college level courses in accounting and taxes. I am limiting my remarks to income tax.

The recent trends in tax reforms is disturbing. Since most citizens seem ignorant of the principles of taxation, there is a chance that mistakes will be made that will be costly to all people and result in a reaction that may cause a regression to a 1 party system such as we had back in the 30s and 40s.

Here is an illustration of what has happened so far under the present administration in tax changes. This red line shows the tax of 1981. The purple line shows Reagan's 1984 tax change and the brown line shows the new proposed change in the tax. In this graph you can see that the changes for those in the lower and middle incomes is not greatly affected, but for those whose incomes exceed a quarter of a million dollars a year, will have their taxes reduced greatly.

The idea behind the "trickle down" economy theory is that the wealthy will use the money they save in taxes for capital and plant improvement and expansion and that this will provide more jobs and that some of this money will trickle down to the poor. This economic theory does not appear in textbooks, but in the minds of those who want the taxes of the wealthy to be reduced and the tax burden shifted to middle income people, "broadening the base". There is absolutely no guarantee that by cutting the taxes on the extremely wealthy that this tax saving will ever be used for such capital expansion and that the money will eventually "trickle down" to the poor.

President Reagan said in his tax speech that under the new tax system that now people could become wealthy and that we should "go for it". This is absolutely true. The wealthy can indeed become more wealthy by having a total of nearly 50% cut in taxes from the 1981 rate for those whose incomes exceed a million dollars a year. In 3 years, the savings in taxes will exceed 1 million dollars for such a person. Do we want an economic system where the rich become richer and the poor become poorer? Examine the nations of the world and see the nations where there is a great spread between the extremely wealthy and extremely poor and you will find the nations where economic discontent runs high and communism runs rampant.

A better solution to the problem of tax change and simplification is a bracketless tax whereby the transition between income brackets is smooth and uniform. If the authorities insist on a percentage range between 15% and 35%, why go about it with sudden jumps of 10% between brackets. Don't they have mathematicians in Washington? If they want a smooth transition between 15% and 35% all they have to do is use a factor such as .00825% per thousand and they can accomplish the same thing. It's simple and a lot more fair and gives a smooth transfer from 15% to 35%. This would discourage cheating to achieve a lower bracket. Let's make taxes fair and as painless as possible.

The best way to set income taxes, where all people pay their fair share of taxes and tax burdens become equalized, is a straight bracketless tax. A person with a net taxable income(after deductions) of $1,000 should pay the same burden of tax as a person with an income of $1,000,000. The poor should pay some tax to let them know that government costs money and that any rise in government spending will be money out of everyone's pocket. The only way to achieve this is with a bracketless tax. A flat 15% tax on a person with a net taxable income of $1,000 is excessive. A tax of 35% on a person with an income of over $1,000,000 is no burden at all. A simple bracketless tax would place the burden of taxation evenly.

A person with a net taxable income of $1,000 should pay the same proportional tax as one with an income of $1,000,000 but not the same percentage. A straight progressive, bracketless tax will accomplish this very easily and simply. The bracketless idea in taxation lends itself to an infinite variety of variations. The key percentage used in my illustration is .005% times the net taxable income (after deductions) rounded to the nearest thousand. For example, a net taxable income of $34,285 would be 34, which is the nearest number of thousands times .005% and that equals 17% which is the tax percentage. 17% times the net taxable income of $34,285 equals $5,828 which is the tax due. This tax helps those in the middle and lower incomes and yet gives an equivalent burden of taxes on those in the higher income brackets. This form of tax is even more simple to figure than the older-fashioned bracketed tax and is far more fair and equitable. This tax is also keyed to inflation and deflation as it is based on the National Average Individual Annual Income and it therefore never becomes out of date. As the cost of living and incomes go up or down, the tax moves proportionately with the change.

Comment:

-This tax would not be revenue neutral, but would be revenue positive and would actually help raise revenue to reduce budget deficits which are a disgrace to our nation.
-It would balance tax burdens for all, from the poor to the middle incomes and for the most wealthy, in relation to the ability to pay.
-Under the regulations contained in the summary, all individual incomes would be required to pay their share of taxes. Those incomes showing losses would not be able to balance those losses against incomes that showed no losses. For example, a doctor who had a net income of $100,000 with a side business of a feedlot that showed paper losses due to depreciation, travel to and from on the way to a resort, etc would not be allowed to balance such losses against the income from his practice. No taxes would be due on the feedlot, but his $100,000 from his practice would be fully taxable.
-Deductions for entertainment, business expenses, depreciation, etc are limited.
-No liquor expenses of any kind are deductible.
-Conventions, meetings, training sessions, etc, must be held within 80% of the perimeter of the area being served and can never be held outside the nation and be deductible.
-Interest deductions must be limited to 12% of adjusted gross income.
-All taxes are deductible but limited to 1.5 times the national average individual annual income. State and local taxes must be deductible up to the above limits as many Federal functions have been shifted to local governments.

Stan Gilbertson
8519 Franklin Road
Boise, Idaho 83709

Please see the Bracketless Tax Proposal summary accompanying this presentation.

ADVANTAGES OF THE BRACKETLESS TAX SYSTEM

1. Bracketless tax rates are simple and easy to calculate. There are no sudden changes in "bracket" rates. The increase in tax rates is fairly constant for all incomes.

2. Tax rates are tied to the National Average Individual Annual Income, (NAIAI) to the nearest thousand dollars and are thereby equitably indexed to inflation and deflation of incomes and purchasing power.

3. Tax forms can be greatly simplified for most taxpayers as there is a generous standard of deduction of 15% of income up to a maximum amount of 1 times the NAIAI. Most taxpayers would not need to use deduction forms, but could use this standard 15% deduction. Rates and forms could remain the same year after year and there would be no need to learn new forms. Audit proceedures would also thereby be simplified.

4. The need to cheat to avoid higher brackets or percentage rates would be eliminated. Tax "loopholes" are also eliminated. Simplicity tends to eliminate cheating and provide more efficient administration of the tax laws. More taxes will be collected from the ones who can best afford taxation. Bracketless tax is on a constant percentage and thereby does not weigh excessively on lower and middle incomes.

5. A special personal exemption scale to help singles and single parents will tend to discourage cheating. The personal exemption scale also tends to help the single parent with dependents and it also equitably spreads child training and educational costs for families of excessive size and helps control population ratios.

6. This plan makes more money available for consumer spending to stimulate the economy and raise the standard of living for the lower and middle income people, who are the nation's majority. More money will be available for savings to stabilize the lower and middle income family finances. Those who need to save and provide for themselves will have a tax incentive.

7. This system will stimulate small business owners who are generally in the lower incomes as they are putting their money back into their business to build it. Small business owners constitute a large proportion of all American business owners and this tax system will help them stabilize their business by lowering their tax burdens.

8. This tax system will reduce social discontent by eliminating tax favors for the very rich. It will increase respect for the government and the tax system by eliminating the ability to cheat and set up tax "dodges" and other tax escapes.

9. This system will flatten tax shelters and pension plans favoring the very wealthy. There is no social benefit for society in favoring the extremely high tax favored pension plans for the wealthy. Only the extremely wealthy can afford extremely high contributions into a pension plan. Those that most need to save can not usually afford such tax shelters.

10. This system provides fair taxation of capital gains and will control speculation, which adds nothing but social costs and inflation to the economy of a nation.

11. The bracketless tax encourages charitable giving which is socially beneficial, but at the same time, it requires charitable institutions to publicly report responsible financial activity and to prove themselves socially beneficial to mankind and to otherwise qualify for tax deductible contributions and charitable status.

12. This system will tend to reduce labor unrest by flatening spendable incomes. It will also tend to balance the inherent advantage of excessive wealth against the national average individual annual income.

13. This tax system will eliminate large tax writeoffs with various schemes of balancing one source of income loss or gain against the losses or gains of another resource, business or source of income. All business salaries or sources of income must be taxed or show losses on its own basis and losses or gains cannot be balanced against other sources of income. No fast writeoff on depreciation or other other such avoidance of taxes are permissible.

15. This system of taxes will raise the maximum amount of taxes from the citizens in the most fair and equitable manner possible and still allow maximum incentives for productivity.

16. The "Trickle Down" theory of economics simply does not work. Rather, it benefits most, those in very high income brackets. The working people who constitute the majority of the population are not helped, but are generally hurt by this type of economic policy. A strong economy which benefits the majority of the population is based entirely on a strong position of the middle and lower income people, who constitute the bulk of consumers, small business and productive people. This new tax system greatly strengthens the savings and security of the lower and middle income people and thus stabilizes the economy. Discontent in society reduces in proportion to the flatening of the ratio of prosperity of the middle income people to that of the most wealthy. The Treasury Plan encourages taxes on corporations which tends to be shifted to the consumer as a "business expense", thereby corporation taxes tend to have a regressive effect by making consumer goods more costly to the general public.

17. This tax will not be revenue neutral, but will raise revenue because tax avoidence schemes will not be permissable in revenue shifting to create "losses" to balance against incomes, it will limit pension and retirement plan savings with deductibility limited to 1/4th of the NAIAI.

18. This system will encourage youth to get training in productibility through work. It will encourage employers to start on-the-job training programs with tax advantages. By limiting qualifying incomes to 1/4th the NAIAI it will avoid exploitation of youth. It will tend to encourage the employment of youth in seasonal work such as harvesting and reduce the employment of illegal aliens. It will tend to reduce juvenily delinquency problems.

19. By its fairness, this system will increase respect for the tax system and the Federal Government in particular as tax avoidance schemes will not be permitted.

20. Progressivity, which has been the standard in America for many years will be maintained, yet the unfainess of the old system because of the encroachment of inflation will be completely changed. The new system is completely indexed to inflation.

AN EQUITABLE BRACKETLESS TAX STRUCTURE FOR INCOME TAX

A Brief Outline

All taxes must be levied according to the ability to pay and also the amount at risk. Since the wealthy have the most at risk, naturally, they must pay the highest percentage of tax. This higher percentage of tax will also tend to equalize the inherent advantage of wealth. Taxes must also promote maximum incentive to high effort with rewards of good income.

All incomes besides wages or salaries, including all other benefits, goods, lodging, etc, furnished by another party, entity or business, with certain exceptions, must be considered income and those benefits must be figured at fair market value and taxed as ordinary income. The exceptions to the above are pension plans which benefits do not exceed 1 times the NAIAI, health plans, life plans which do not exceed 10 times the NAIAI and disability income plans that do not exceed 3/4 the national average individual monthly income or 3/4 the receipient's average monthly income, whichever is least.

Capital gains of any kind must be taxed as ordinary income in all cases, except for the amount of inflation that has occurred since acquiring such property. Other reasons for the increase in value of property or capital gains is a windfall and are not deductible and must be considered ordinary income. Such gain in capital value must be figured in the year in which sold or disposed of or money actually received. Such tax on capital gains is to discourage speculation, which is generally socially costly and inflationary.

Each source of income or loss from wages, salaries, business or other resource, must be figured on its own basis and taxed separately and losses or gains from other sources cannot be balanced against losses or gains from other sources of income for any individual or entity. This is to discourage "tax shelters".

All costs of doing business may be deducted from income with the following exceptions: No alcoholic beverage or other drug expenses of any kind may ever be deducted, as alcohol and other drugs tend to be socially harmful and add nothing to the general welfare of citizens or to the economy. Entertainment expenses such as shows, performances, or other theatrical displays may not be deducted, however, meals may be deductible where used directly in business transactions and for such other needs as training seminars or sessions, awards given and other such necessary business functions. Such costs of meals, lodging, travel, etc., must approximate that of the national average. Other entertainment such as sporting events, shows, outings, vacation trips, etc., cannot be deducted as business expense.

All meetings, conventions, training sessions, seminars, etc. must be held within 80% of the periphery of the area in which the business is conducted or territory served by that business establishment and can never be held in a foreign nation or outside this nation or on a cruise ship, regardless of the territory served and still qualify as a tax deductible expense

Irrevocable and short term 10 year trusts to reduce taxes may be set up for various purposes, but must never exceed an amount needed to furnish an income more than 2 times the NAIAI per receipient, except for a designated charity which qualifies as a charity under other regulations contained herein and doesn't benefit a close friend or relative, either directly or indirectly.

(NAIAI - National Average Individual Annual Income rounded to nearest thousand, Gov't sources)

Charitable contributions, to be deductible, must not exceed 50% of income. The first 5 % of charitable deductions is included in the standard 15% miscellaneous deduction up to 1. times the NAIAI. All charitable deductions must be verifiable and well documented, otherwise they must be disallowed. Receipient charities, to qualify as a tax favored institution, must be dedicated to public use, access, utility or benefit. If a private or religious institution, such entity must actively promote peace, tranquility and social betterment by peaceful and lawful means as well as provide beneficial spiritual inspiration and services for members and society in general and may not be a secret society or entity. Socially destructive, unlawful or engaging in acts harmful to individuals or coercive in nature, must immediately disqualify a religious or charitable institution from charitable status and from receiving tax deductible contributions for 3 years. To requalify, such institutions must prove its qualifications before again becoming a charitable institution.

Detailed financial reports of any religious or charitable institution must be made public on demand. Such reports must explain in good detail the financial activities of the entity, the percentage used for administration, salaries and wages and other benefits for the top executives and their relatives from such institution and the benefit of each charitable act or function undertaken within the past year. Charitable entities of all kinds must prove the need for all property owned, but not directly used in connection with their charitable functions or acts. Charitable contributions must never benefit close friends, or relatives of managers or executives of such charity, either directly or indirectly. The director or individual managing or running the charity must never earn more than 40% of the yearly income of that charity. Charities of any kind must be managed by a board of directors of at least 5 adult unrelated people, if it is to qualify as a charitable entity.

In corporations, propietorships, partnerships or other forms of entities, unreasonable accumulation of reserves or resources of any kind, not directly and presently needed for the operation of the enterprise, must be considered undistributed income to the owners and taxable as such. Gain within an entity must be considered income to receipients or owners if exceeding 12% per year. Dividends of any kind from such entities must be considered as ordinary income and taxable to the receipient or owners as such.

An exception to the above shall be dividends on life insurance which are used to buy additional life insurance or refunds of premiums. Life insurance proceeds are a valuable social benefit and must never be taxed if not exceeding 15 times the NAIAI per receipient. Accidental death insurance is an aleatory contract and generally does not serve as valuable purpose as life insurance in social stability and therefore should be taxed as ordinary income if exceeding 10 times the NAIAI.

Tax free bonds or other such tax favored investments must be held tax free in proceeds to the receipient up to 3 times the NAIAI per receipient, except charitable, pension or public entities of a socially beneficial nature, who can hold unlimited amounts of such investments.

Depreciation of any kind of property worth more than the NAIAI up to 10 times the NAIAI must be figured on at least a 10 year basis with a level 10% per year schedule. Property of a value greater than 10 times the NAIAI must be depreciated on at least a 20 year basis or longer on a level percentage basis. Exceptions to this rule will be catastrophies which damage, destroy or reduce the value of the asset, obsolescense or other mitigating circumstances.

Taxes on corporations or other entities should be minimal, but should be sufficient to pay the costs of regulation and raise some revenue. Generally, taxes should be raised from the incomes of the owners of corporations when they receive such income. Evasion of declaring dividends or in creased salary by building cash reserves, inventory or assets of the entity to excessive limits must be audited periodically. Taxes on corporations are generally passed on to the consumer and thereby become a tax on the consumer.

Totally employee owned entities are generally more socially efficient, more business efficient and more free from labor management strife and therefore should be tax favored in relation to the percentage of employee ownership. An entity totally owned and operated by its employees who actually do productive work for the entity should be taxed at 1/2 the rate of regular corporations. The percentage rate of actual employees owning such corporation or entity shall determine the tax rate of such corporation or entity in relation to regular corporations where there are no owner employees. The minimum percentage of such owner employees shall be 25% to qualify for such tax benefit. The shares of ownership must be in proportion to the number of employees who participate in ownership.

The basic tax rate is based on 6% of the National Average Individual Annual Income, increasing .005% for each thousand above and reducing the same amount for each thousand under the NAIAI. At 35% the percentage changes by .0005% for each thousand above to 60%. Above 60% the change in increased percentage is .00005% for each thousand higher to a maximum percentage of 65%. Example: Net Taxable Income of $53,221. To find the tax rate, simply multiply 53 (the nearest thousand) times .005 equals .265% times $53,221 equals $14,103 the tax to be paid on such income. The rate change is uniform and gradual.

There shall be a standard deduction of 15% of the taxpayer's adjusted gross income with a total limitation of such deduction to [illegible] times the NAIAI regardless of income. All other deductions must be completely listed and documented. This standard deduction shall cover all regular deductions such as interest, other taxes, medical and dental expenses, minor losses, thefts, educational expenses and miscellaneous expenses. This limitation shall not include charitable contributions greater than [illegible] % of income or catastrophic losses greater then 10% of income or greater than 1.5 times the NAIAI whichever is least. All such deductions must be completely verifiable and documented.

An additional deduction is allowable for money irrevocably allotted to health, disability, death or retirement insurance plans. This amount is limited for all taxpayers to 1/4th of the NAIAI. Irrevocability must be absolute to normal retirement age, death or disability depending on the particular benefit allotted. Such funds cannot be surrendered, borrowed against, or used in any way except for the benefit guaranteed. Such benefits must not be taxed unless they exceed 2 times the NAIAIper year

There shall be a standard exemption of 1/4th the NAIAI for all primary taxpayers. The 2nd exemption of a given tax form shall be 1/5th the NAIAI. The 3rd exemption shall be 1/6th the NAIAI. The 4th exemption shall be 1/8th the NAIAI. The 5th throughthe 8th exemptions shall be 1/10th of the NAIAI. Further exemptions shall be 0.

Exceptions to this rule will be children adopted, foster children and, or parents of the taxpayer who are over normal retirement age with incomes not over 1/3 the NAIAI for each, or incapacitated individuals who are unable to do productive work and who earn not over 1/3 the NAIAI. Such individuals shall be entitled to an exemption of 1/10th the NAIAI each.

Unlimited charitable deductions may be made above 10% of adjusted gross income, even though total deductions of all kinds do not exceed the standard deduction. If the standard deduction is used instead of itemizing, the deduction may be made of the excess above 10%.. In all such cases, all charitable deductions must be listed, verifiable and documented.

Interest for individual tax returns may not deduct interest in excess of 12% of the adjusted gross income or the NAIAI, whichever is the least.

State, local and other taxes are deductible up to 1.5 times the NAIAI.

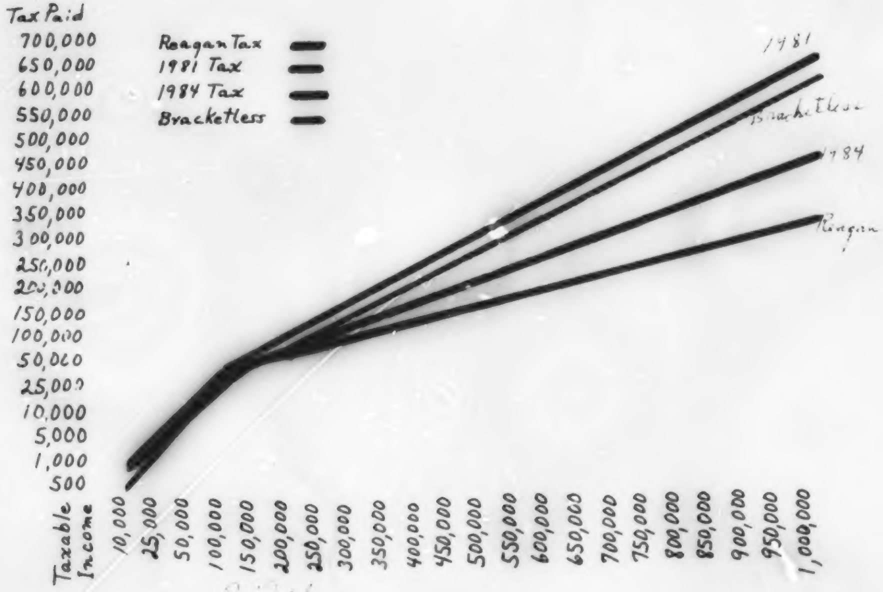
Individuals under the age of 21 whose incomes are under 1/4th of the NAIAI and are attending school or some kind of vocational training shall be considered students or trainees and may be employed with compensation tax free up to 1/4 the NAIAI and still qualify as a dependent. Such income may be free from unemployment tax and benefits, workmen's compensation tax and benefits and Social Security costs and benefits, but liability for injury while employed must rest with the employer and be covered by insurance. This paragraph is to encourage youth employment.

This is not a tax code, but rather an outline of an income tax system that has many advantages listed elsewhere. This tax will raise more revenue than the present system as it limits deductions and eliminates loopholes and shelters, yet it relieves those in the lower incomes from unfair and burdensome taxation. For further advantages, see acompanying sheets.

Please note : NAIAI is the National Average Individual Annual Income rounded to the nearest thousand dollars.

Single Rate

Tax Comparison



Single Rate

BRACKETLESS INCOME TAX

Net Taxable Income	Percentage Tax	Tax Paid	Remainder After Tax	
$10,000	.05	500	$9,500	Based on .005%
12,000	.06	720	11,280	
15,000	.075	1,125	13,875	
18,000	.09	1,620	16,380	
19,000	.095	1,805	17,195	
25,000	.125	3,125	21,875	
30,000	.15	4,500	25,500	
40,000	.20	8,000	32,000	
42,000	.21	8,820	33,180	
43,000	.215	9,245	33,755	
50,000	.25	12,500	37,500	
70,000	.35	24,500	45,500	Change to .0005
75,000	.3525	26,437	48,563	
100,000	.365	36,500	63,500	
150,000	.39	58,500	91,500	
200,000	.415	83,000	117,000	
250,000	.44	110,000	140,000	
300,000	.465	139,500	160,500	
400,000	.515	206,000	194,000	
500,000	.565	282,500	217,500	
570,000	.60	342,000	228,000	Change to .00005
750,000	.609	456,750	293,250	
1,000,000	.6215	621,500	378,500	

The basic tax should be 6% of the National Average Individual Annual Income, increasing .005% for each thousand above and reducing the same amount for each thousand under the NAIAI. At 35% the percentage should change by .0005% for each thousand above to 60% at which time it should change by .00005% for each thousand higher. The maximum percentage should be 65%. See attached sheets for further regulations.

REAGAN'S TAX REVOLT

SINGLE RATE

Net taxable Income	Percentage	Tax	Remainder After Tax
$12,000	15%	$1,800	$10,200
15,000	15%	2,250	12,750
18,000	15%	2,700	15,300
19,000	25%	2,950	16,050
25,000	25%	4,450	20,550
30,000	25%	5,700	24,300
40,000	25%	8,200	31,800
42,000	25%	8,700	33,300
43,000	35%	9,050	33,950
50,000	35%	11,500	38,500
75,000	35%	20,250	54,750
100,000	35%	29,000	71,000
150,000	35%	46,500	103,500
200,000	35%	64,000	136,000
250,000	35%	81,500	168,500
300,000	35%	99,000	201,000
400,000	35%	134,000	266,000
500,000	35%	169,000	331,000
750,000	35%	256,500	493,500
1,000,000	35%	344,000	656,000

The defects in this tax system are several - First, there are three brackets involved which each require tax computation, depending which bracket one is in. Secondly, the brackets lose progressivity in the higher incomes. The excuse put forth for using this tax system is simplicity, and this is not achieved. Tax progressivity must be maintained in a democracy. It has been pointed out that this tax will eliminate many tax shelters and tax dodges to reduce liability, but this can also be achieved with a regular progressive tax. Bracketless tax is much simpler, much more fair for all and can avoid tax shelters and tax dodges as well as reduce our present extremely liberal deductions. Please see the accompanying Bracketless tax proposal.

REAGAN'S "TRICKLE DOWN" 1984 INCOME TAX

SINGLE RATE

Net Taxable Income	Percentage Tax	Tax Paid	Remainder After Tax
$12,000	.11856	$1,424	$10,576
18,000	.1498	2,697	15,303
25,000	.1829	4,573	20,427
30,000	.208	6,122	23,878
40,000	.2439	9,759	30,241
50,000	.277	13,879	36,121
75,000	.34	25,571	49,425
100,000	.379	37,900	62,100
150,000	.419	62,850	87,150
200,000	.4396	87,920	112,080
250,000	.45	112,500	137,500
300,000	.45978	137,934	162,066
400,000	.4698	187,920	212,080
500,000	.4759	237,950	262,050
750,000	.4829	362,925	387,075
1,000,000	.4879	487,900	512,100

From the rate of 1981, the tax rate on $1,000,000 was cut by $191,987. This cut in taxes on the extremely high incomes was over 15 times the National Average Individual Annual income! The wealthy were helped considerably by this tax cut, but the price to the middle and lower income groups was extremely severe in higher interest rates, unemployment, business stagnation and economic dislocations. A strong and stable economy must be based on strong and stable middle and lower class income people. Much of the business conducted in America is conducted by small business with owners in the middle and lower incomes.

1981 INCOME TAX RATE

SINGLE RATE

Net Taxable Income	Percentage Tax	Tax Paid	Remainder After Tax
$12,000	.1535	$1,843	$10,157
18,000	.1947	3,505	14,495
25,000	.238	5,952	19,048
30,000	.265	7,962	22,037
40,000	.316	12,657	27,343
50,000	.36	18,067	31,933
75,000	.445	33,393	41,607
100,000	.501	50,100	49,900
150,000	.5659	84,447	65,133
200,000	.599	119,887	80,113
250,000	.6195	154,887	95,113
300,000	.63	189,887	110,113
400,000	.6497	259,887	140,113
500,000	.6598	329,887	170,113
750,000	.67	504,887	245,113
1,000,000	.6799	679,887	320,113

This tax, although it had very good progressivity, has become outdated due to inflation and shifts in income in our population. This tax had become disproportionately heavy on the lower incomes. Progressivity must be maintained, but the tax must be lightened on the lower incomes as the national average annual individual income has increased and with it, the average cost of living.

Senator SYMMS. Thank you very much for a very thoughtful statement, Mr. Gilbertson. That's very interesting. And I'm going to take a good look at that.

The next witness is Dave—how do you pronounce your name?

Mr. HAGUE. Hague.

Senator SYMMS. Hague. Oh, that threw me a curve there. I thought that was a "q," and it didn't quite look right.

Dave, welcome to the committee.

STATEMENT OF DAVE HAGUE

Mr. HAGUE. Thank you, Senator.

My name is Dave Hague, and I'm testifying as a private citizen representing myself. My business activities consist of investing in stocks and bonds and development of commercial real estate.

I understand the purpose of this gathering is to take testimony regarding the proposed impact of President Reagan's tax reform proposals.

I will limit my comments to the proposed 10-percent dividends paid tax credit and the 85-percent dividends received deduction and the proposal to eliminate the $100 exclusion for dividends on individual returns.

As it stands, this proposal does not meet the stated objective of fairness in tax reform. As it stands, this proposal places the small investor at a competitive disadvantage with corporate investors.

This can be made equitable by authorizing individual investors to take the same 85 percent dividends-received deduction. And I urge you to do this.

Senator SYMMS. Thank you very much.

Mr. Gilbertson, before I get away and forget the question, that example you used about 17 percent, how high up would your rate go?

Mr. GILBERTSON. It goes up 65 percent; the old 1981 was 70 percent. It can be—it's not fixed. It could be 60 percent, it could be 50 percent, or any percentage that a person would want.

Senator SYMMS. Well, see, the statistics show that the rich people, since 1981, the high-income people, have paid a lot more taxes than they paid before 1981, even though the rates are lower. And they get a tax break on your graph, but they do more things because of the lower rates and as a response it generated more income, and they had higher income and they have paid more taxes.

Mr. GILBERTSON. They get a tax break on your graph, too.

Senator SYMMS. I understand that they get an individual tax break, but I'm talking about in total, the high-income people are paying a higher percentage of the total tax burden than they were before the 1981 act, even though the rate went from 70 percent to 50, because they make more transactions. So their net income is higher. And even though a lower rate, they have paid more dollars.

Do you see what I'm saying?

Mr. GILBERTSON. I see what you mean.

Senator SYMMS. And that's why I was questioning about that bracket.

Mr. GILBERTSON. That bracket has variations in it which I'll give you——

Senator SYMMS. Yes. I would be very skeptical of any tax that went above 50 percent. I mean, to me it's confiscatory.

Mr. GILBERTSON. It didn't used to be.

Senator SYMMS. Well, it always was; it's just a matter of how—that's where all these deductions came from, I suppose.

Mr. GILBERTSON. It could be limited to 50 percent in the upper bracket.

Senator SYMMS. It could be.

Mr. GILBERTSON. Sure.

Senator SYMMS. Well, I'll take a look at that.

OK. Now we'll hear from Mr. Ralph Smeed.

Are you speaking on behalf of the Senate or Market Alternatives, or as an individual businessman?

STATEMENT OF RALPH SMEED

Mr. SMEED. Thank you, Senator Symms.

I don't have prepared remarks here. I don't want to tar the Senate or Market Alternatives' lives with what I'm about to say.

The reason I don't have prepared remarks is, I didn't plan to make any here. But I appreciate the invitation and I appreciate what you gentlemen are trying to do, I think. But I should like to challenge the premise of the hearing.

For example, it seems to me—let me oversimplify. It seems to me that the problems are in Washington, DC, and the solutions are out here. We ought to have this hearing thing reversed. We ought to have some people ask the Congressmen and the Senators why they have screwed things up so badly in the past several decades. And it seems to me that it's not a question of being sincere, although one could make a good argument for that, I guess.

But here we just were afforded this opportunity a little bit ago to hear a couple of educators; that is, one of them was representing some administrators in this State, and the other one was an educator at Northwest Nazarene College.

And if I hear what they're saying, they're saying they have a vested interest; they have a special interest.

That's supposed to be bad. They tell their students that special interests somehow are bad. I'm suggesting what we need is more loopholes and more tax gimmicks. And what we need to do is get government off of the backs of people and let them produce things.

Now, we had a pricing system here once years and years ago. My understanding was at one time even you were in favor of it. I don't know what we've done about that.

Senator SYMMS. Still am.

Mr. SMEED. Well, good. I'd hoped to hear this in the newspapers.

In any event, what I'm suggesting is that these people really genuinely do have a vested interest in high taxes and high tax brackets. They think that somehow or another that this is going to encourage people to give their institutions, their organizations more money, because if they don't, they'll have to give it to the rascals in Federal Government.

And I quite agree with the latter part of that, but I don't believe the incentive works that way. And I think that the basic premise of this thing is the solutions are in Idaho, and the problems are in Washington, DC.

I'd like also to say that, you know, and it ought to be taken into consideration—I have no plan, by the way, for making government efficient. I think it's a contradiction in terms.

And I'm dead serious, but it's pretty hard because of these educators, in their great wisdom, telling their students, "If you have a problem, write your Congressmen."

I'm saying if you don't like the way the thing is, get into business if you don't like the way they're doing it, or making too much money. Get into business and do it for yourselves.

But we don't tell the children that. And I'm suggesting that you fella's in Congress now have an education department now, you have a Secretary of Education, and they'll screw it up even worse; you watch. They already have, but—and I'm sure that you probably may agree. I'm not sure you can get elected on that.

And what I'm saying, even if you were to come up with——

Senator SYMMS. It's worked so far.

Mr. SMEED. Yes; it sure has worked so far. But even if you come up with a gimmick like the gentleman at the end of the table here suggested, one that, on the surface, even to me, sounded like it might have made a little bit of sense.

But even if you do, by the time you fella's get a law passed and you entrench that idea, it will be out of date. It will be a couple of years' time lag before it makes any sense, if indeed it does to begin with.

If you want to make government efficient, how are you going to do this with a giant committee with a 2-year time lag?

It seems to me, also, that the farmer—the dairyman that spoke here a moment ago posed a good problem. He's talked about the cash basis and the accrual basis. Why doesn't somebody bring up how the farmer is being harassed out of business because the doctors and lawyers and other high-income people that need a tax gimmick, they want to get in that business, in real estate, because the Government has a printing press. And they cause inflation. They don't cure inflation; they cause inflation. I'm sure that you agree with that.

But there's a terrible semantic jungle out there. I don't know if it's because or in spite of these good educators that are here today, some of them that are here today.

But I'm suggesting if the Government would stop printing this money, and if they would stop meddling with their affairs, then people wouldn't have to rush out there and buy a farm—they need a tax gimmick thing. They need an inflation hedge.

This is precisely the fault of government. This is precisely why we need to reduce government and expand the private sector. What we need is more loopholes and more tax gimmicks, and each one of those diminishes the government to some degree.

And it seems to me if we had a doctor, and he was giving us a worse bellyache every week or every day, that if we didn't fire him, we'd sure stop taking the medicine.

I'm just suggesting that the medicine is out here in Idaho, and it's you fellows that have the problem back there. You ought to get off of these people's back with your quack doctors.

Now, it's my understanding that the Forest Service has a statistic that says that the rate of—that tends or portends to state what the rate of decay is in the forest, most of which are owned by the government—and how can you get more socialistic than that, by the way? But anyway, my understanding is that they have that statistic, and I'm told, by what I think is competent counsel, that that's a far larger figure than the imports that are coming in from Canada.

The United States, for example, has taught everybody in the world the word "subsidy." All you have to do is have a government, and they don't say too much about the printing press, but, of course, that's what makes it function.

And I'm suggesting that the only way we'll get this thing down to manageable proportions is to get these assets that the Federal Government is now mismanaging at a rate in excess of over $1 billion a year, is to get them out and get them into private enterprise. But I don't know how you're going to get elected on that basis, because I know that that's an unpopular stand, thanks to most of the educators that you people seem to be soliciting all the time, wanting to give them more money.

I should say that we should ask Mr. Shaw how he supports—now, he said he was a political scientist. And I'm sure he's sincere. I read his column in the paper and I at least get that out of it, but what I'm—you heard him say a little bit ago, he's a political science professor, not an economist. And I don't—you can call him back and let him rebut, if you like, but I think he's sincere. I think that he wants you fellows to do good things.

But it's a contradiction of terms to have the Government regulate the economy and do good things.

I guess I could wind up——

Senator SYMMS. I thank you very much.

Now, are you suggesting with respect to all of this government ownership in Idaho, that if some of that government-owned land was held by the private sector, maybe the tax rates would be lower on everybody?

Mr. SMEED. Some of it is held by private companies. But the private companies would rather that you people would resource—would warehouse their resources.

Senator SYMMS. A third of Idaho is owned by private enterprise, private individuals, and two-thirds of it is owned by either State or Federal government.

Are you saying you think that ratio is too high?

Mr. SMEED. Indeed, I think it's too high.

What I'm saying is that the timber companies and the timber industry seems to have come to the conclusion, in their great wisdom, that they would rather warehouse those resources at government expense than they would under private ownership. And I think that's part of the problem. And I challenge you to challenge the educators of this country, and you ought to do it at hearings like this. What are they teaching? They're worried about getting more money. More money for what? More money to teach these kids about writing their Congressmen.

I suggest that's where the problem is.

Thank you very much.

Senator **Symms**. Thank you.

I thank all the witnesses very much.

[Whereupon, the panel members were excused.]

Senator **Symms**. And I'll call up our last panel for the day: Tim Brennan, Idaho Retailers Association; Tom McMannis of Food Marketing Institute; Dennis Shaver, Shaver's Markets.

And we'll take just about a 2-minute recess, and then we'll commence with the last panel.

[Whereupon, a brief recess was taken.]

[Whereupon, the panel members assembled.]

Senator **Symms**. The subcommittee will resume our hearing.

We have had some excellent testimony so far today to help us with the deliberations of this legislation.

And at this point we'll hear from Tim Brennan of the Idaho Retailers Association.

Mr. **Brennan**. Thank you, Senator Symms.

To begin with, I would like to defer, before I make my statement, to a representative of our association and a representative of the Food Marketing Institute nationally. And I'd mention that Dennis Shaver is unable to be with us because he's attending a State legislature hearing as a member of an interim committee in my behalf that's meeting also in the caucus room of this building.

Fortunately, I was able to leave there and get up here, what I felt was on time but was obviously late, and I apologize for not being available when you called.

But I would like to have Don McMannis make our first statement, and then I will follow with an additional statement.

Don represents Food Marketing Institute, which is a national organization representing the food industry. It has several members in Idaho and is also affiliated with the Idaho Retailers Association.

I might mention that I'm the president of the Idaho Retailers Association and have been in that position for 25 years and am the official spokesman for the retail industry of the State of Idaho.

We have approximately 600 members spread out throughout the entire State, and we're very interested in this issue.

And I would like to have Mr. McMannis start off.

Senator **Symms**. OK. Welcome to the committee, both of you.

Just as a statement, a question before you start, retailers as a group would be considered high tax bases; is that not correct?

Mr. **Brennan**. Absolutely. We pay among the highest category of all the portions of our economy and tax system, maximum normally, with very few advantages of the tax breaks that are given other industries.

Senator **Symms**. How do you square with the question of international competition? If you have got a retailer here—you know, two retailers in Boise competing against each other and, of course, they may be high taxpayers but if they make a profit, ultimately those customers have to pay that profit to them; isn't that correct?

Mr. BRENNAN. Obviously, we're a pass-through industry. We're also interested in making a profit, but an awful lot of that profit we make is paid in taxes.

Senator SYMMS. Well, I won't get diverted here to the questions, but this is a question that bothers me a lot because I have talked to Food Marketing Institute in Washington, and Mr. Cook has talked to me about this bill. And he's very favorable towards it.

And he would be, Don, I guess your representative in Washington?

Mr. McMANNIS. That's Grocery Manufacturers Association.

Senator SYMMS. That's Grocery Manufacturers; correct. Excuse me.

Mr. McMANNIS. And we are—the industry is really together; George Cook with the Grocer Manufacturers, the National Grocers Association.

Senator SYMMS. And Tom House is your man in Washington?

Mr. BRENNAN. Well, Sullivan—Harry Sullivan and Tom Little are taking this particular issue.

Senator SYMMS. I know Harry Sullivan.

Well, go ahead and testify, and then I want to ask a question of how it relates to the—the people who are trading internationally are a little less able to pass on their costs. If they have higher taxes, they just have to pay money. So the moneys of production have to swallow it, which may mean layoffs and job slowdowns.

That affects retailers, too, because you sell to those people that work for them. And that's a point I'd like to get to.

But go ahead and make your statement.

Mr. McMANNIS. That's fine.

STATEMENT OF DON McMANNIS ON BEHALF OF THE FOOD MARKETING INSTITUTE

Mr. McMANNIS. Of course, you realize, Senator, that I'm here on behalf of the President's—we are four square behind the President's tax proposal. The industry is together, the National Grocers Association which has independents only; however, about three-quarters of our membership are independent and regional chains.

Just to remind you that the industry, Food Marketing Institute, has 1,500 members that operate 17,000 grocery stores with a volume of $140 billion, about half of the volume throughout the country.

The NAGA, which is the wholesalers association, has also come in behind this. The National Association of Convenience Stores is on board, and the entire food industry is behind the President's tax reform and simplification.

And as a citizen, I'm behind it also, the simplification portion of it.

I'm sure you have heard many of your citizens complain through the years as to how difficult it is to be a taxpayer in the United States today.

Senator SYMMS. I don't want to interrupt your testimony——

Mr. McMANNIS. Sure.

Senator SYMMS [continuing]. But you say you're in favor of the President's tax proposal. Do you believe that the Food Marketing

Institute, if the President would have proposed the Kemp-Kasten bill, for example, that you'd still be behind that one also?

Mr. McMannis. Yes; I do. I don't have the details, but the way I understand the Kemp-Kasten bill, I believe that we would be behind it.

Senator Symms. In my opinion, it's a lot better bill than the President's bill. It doesn't take every special interest group in the country, but it lowers the rates, and it would lower the tax rate——

Mr. McMannis. We don't think——

Senator Symms [continuing]. On food marketers, as does this bill.

Mr. McMannis. We don't think there is any such thing as a perfect bill. And certainly the Kemp-Kasten bill is not a perfect bill, certainly Treasury I was not a perfect solution.

However, we like portions of Treasury I even better than we like the President's; particularly in the area of relief from double taxation and corporate dividends.

The food industry is one who pays dividends. And we're concerned about it.

However, when we look at both of them side by side, we come down on the side of the President's. And, however, we'd like to see a little change in the area of dividends. We can live with the President's proposal, which is 10 percent. Treasury I is 50 percent relief of the dividend problem.

Senator Symms. Oh, I think there is going to be an effort on the part of some of us on the Senate Finance Committee to raise that back up to 50 percent. -

Mr. McMannis. We would, of course, support that. However, I think that the—you want to get down to the basics on this, why we think that this tax reform, in the form that the President has proposed, why we would be in favor of it.

We would be in favor of it because we believe that at the present time many, many business decisions are being made on the basis of how it affects me taxwise, not market decisions.

We make more market decisions than most people. We just, frankly, do not have the loopholes. We just—we pay taxes. We pay a high rate of taxes.

If others in the entire spectrum of business pay taxes the way we did, there would be more money or we could lower it so that we would all be paying a lower tax, effective tax. Particularly in the retail area, we feel that we pay more than our share.

You know that there are a lot of industries that don't pay any tax at all. Some of them, they're even—they have negative balances with the Government year after year.

We don't understand, for example—one that comes to my mind is General Electric, why General Electric makes money every year but doesn't pay taxes. We think they're a part of business and industry the same as we are. We feel that this should be taken care of and can be taken care of with the President's program.

The President's program has another factor that we're interested in, too. A component of the President's proposal of particular importance is the use of an indexed FIFO. And I'm not up on this. Maybe my retailer friend over here can help me a little more.

But anyway, it has the use of an indexed FIFO method, the repeal of the LIFO conformity rule, and that these are significant improvements, particularly for small business.

We're also concerned with small business in that we would like to keep the President's lower end rates, the graduated rates on the lower end, we would like to see that remain in the bill.

I'm trying to pick out the important portions here that we can discuss.

I think we're probably ready to discuss your problem.

Senator SYMMS. Well, let's let Tim go ahead and testify, and I may have a question.

Mr. McMANNIS. All right. Go ahead.

Senator SYMMS. I thank you very much, Don.

Mr. McMANNIS. You bet.

Senator SYMMS. It's good to have you here.

STATEMENT OF TIM BRENNAN, PRESIDENT, IDAHO RETAILERS ASSOCIATION

Mr. BRENNAN. Senator, I do hesitate to be repetitious, but our interest in the bill is not really that complex. We support the President's legislative proposal, and I support the position of Mr. McMannis in the statements that he has made.

Senator SYMMS. Pull that mike over to you, Tim. I can hear you, but they can't hear you.

Mr. BRENNAN. We support the President's proposal. There are portions of it that we think could be improved, and I think the No. 1 is the change in the double taxation where we're paying corporate income tax on corporate profits, and on the amount of money that's paid in corporate dividends to stockholders, and stockholders are also paying taxes on that.

The reduction of the 10 percent we support, but certainly we would encourage you and support you in your effort to change that to 50 percent. We think that's extremely desirable and extremely equitable.

I do want to mention: The inventory indexing of first-in, first-out and last-in, first-out conformity rule are really very complex. I asked a couple of my key retailers to explain that to me; they brought in their comptroller to explain it.

I think I understand it. If you have some questions, maybe you would want to go into it in detail. If not, I want to emphasize that what has happened in reference to inflation of inventories when something is purchased for a given price and by the time it is sold, it's 10, 20, 30, 40 percent higher in value, that this has significantly increased the tax on that retailer by increasing the value of his inventory and, therefore, if he can report, as some of the large—very large chains do on their last-in inventory, which makes it a higher inventory in turn, show them with a lower gross profit, they pay lower taxes.

The small retailers cannot do that; they flatly cannot adjust to that system, because of the complexity in the bookkeeping system. And the requirements of the LIFO conformity rule by IRS makes it impossible for small retailers to use the last-in inventory, which is the higher value inventory, reducing their gross profits and net profits at the bottom line. They can't comply with that.

And even though it may not be a major portion of the legislation, for us it creates an inequity that does exist. There's an inequity involved with the small retailers. This portion is supported; in fact, it happened to have been Albertsons that was educating me on this issue. They support this concept, even though they're already using that system.

The indexing method for the amount of inflation being determined in an indexing percentage figure being made available and established by IRS and allowing small retailers to use that when calculating the value of their inventory would be very desirable.

Senator SYMMS. How do you do it now?

Mr. BRENNAN. Well, it's understandable, Senator.

Senator SYMMS. Do you use last in, first out now?

Mr. BRENNAN. Albertsons is using last in, first out now.

Senator SYMMS. Last in, first out.

Mr. BRENNAN. Now, as a matter of fact, what they're using is the average of all of their purchases as their cost of merchandise sold on the profit and loss statement; they're using the average.

If they could use the ending inventory—or the last purchased inventory—and that's what Albertsons and large chains are using—their inventory then would be worth more. Therefore, when they subtract that from their sales, their gross profit would be reduced, meaning their net profit would be reduced. They would pay less taxes.

Now, this, of course, is more severe—was more severe when we had the heavy inflation.

Thanks to the Reagan administration, we've been able to slow down that inflation. The problem is not as severe today as it was 3, 4 or 5 years ago.

But when we had 10, 12, 14 percent inflation every year, the retailers were paying the heavy tax on increased inventory values, which were not really profits. You know, it's debatable whether they are or aren't profits. They're inflation profits, and obviously, when they have to buy merchandise to replace the merchandise they sold, they pay the new price for that merchandise.

If you bear with me, I'll give you a specific example. You buy a baseball mitt for $10 today. It's on your inventory. A month from now, you buy another one. It costs $12. What's your inventory value? You sell that $10 mitt for whatever the markup is, you've got to replace it for the $12. So you've got to have cash-flow to replace that merchandise. So you're paying a tax on an artificial, I guess, for a word, $2 of inflation.

The thing that we have here, we have—and I assure you, the large chains also support this concept because they know it's good for the retail industry in general. And maybe that's being very compassionate on their part. But they do support this change which would protect the small retailer and is a very important part of the——

Senator SYMMS. Do you need this change put in the bill, or it's in there now?

Mr. MCMANNIS. It's in there now.

Mr. BRENNAN. It's in the President's bill now.

Senator **Symms**. You'd like to keep it in there?

Mr. **McMannis**. Yes; we surely would.

Mr. **Brennan**. Yes; we'd like to have that kept in.

Obviously, this is complex legislation, and you're hearing a great many different interests, and some not dealing specifically with legislation, obviously.

And I would like to deal with a little discussion on the budget if I might before we finish, because I want to thank you, Senator, for your vote against the budget that was just adopted 2 days before the end of the Congress recess, and thank the rest of the delegation that voted against that budget.

I think it was a phony budget. It's not specifically dealing with tax reform by any means, but I hate to pass up an opportunity to let you know that there is an awful lot of support out here for the idea—and I mean real support, not verbal language support.

I read here in an article: "The Federal deficit threatens our standard of living, the quality of our environment, the future of our children and our grandchildren."

And you hear this kind of statement expounded by the liberals every day, yet when they go to Congress and the Members of the House of Representatives who have been elected as freewheeling spenders and have been supported by organizations throughout their constituency, which are in favor of increased government and increased spending as a matter of avid intenseness, those Congressman can give rhetoric all they want to of the serious problems with the deficit, but they're not going to be able to vote for cuts in spending. They're not going to, when it gets down to the bottom line, as what we just saw in the House of Representatives, the passage of a phony budget that will not cut the deficits. And this might be interesting to you, Senator.

I was just going through some old notes I had of speeches I was giving 3 years ago. And I was saying that it took us 150 years to get to a $1 billion deficit and in the last 20 years, we've gone to an $800 billion deficit, and I thought, "Gee, I think I'll use that again."

And then I quickly realized we're already at $1.8 trillion in deficit, $1 trillion higher than it was 3 or 4 years ago.

And we all know how serious that is, I think. We all talk about it. But when it gets down to the bottom line of a Congressman voting against an appropriation, they aren't going to do it if they're geared for their whole life on voting for spending proposals and their constituency who contribute to their campaigns and support them and help them get elected are coming from that segment of the public that wants an increase in spending in the Federal budget and the expansion that exists—if it existed at the State level the same as it does for the Federal level, it just hasn't got as carried away at the State level because we have some constitutional restrictions, thank God, or we would be in the same position you are at the Federal level.

We do support your position on that.

[The prepared statement of Mr. Brennan follows:]

PREPARED STATEMENT OF TIM BRENNAN

Mr. Chairman and Members of the Committee:

The Idaho Retailers Association supports thorough and fundamental restructuring of the federal income tax system, both individual and corporate. We commend President Reagan for his leadership in making this an objective of highest priority and in taking this issue to the country.

We believe the time for a real restructuring of our income tax system is at hand. It would be highly unfortunate if the Congress failed to avail itself of this opportunity. The existing system in many respects is becoming intolerable, both for the individuals and for business. The tax base in both cases has been narrowed due to a proliferation of credits, exclusions, allowances, deductions, and tax breaks for special provisions in combination with one another, the base has been so narrowed that rates are higher than necessary and economic decisions are drastically distorted.

Industries and companies with approximately equal economic income are treated differently under the present tax system. Some pay no taxes: some actually have negative rates; others therefore have to pay high effective tax rates. The retail industry is among those who pay these high rates. We believe in fairness and a level playing field. We believe in the free enterprise system. Our industry is probably one of the most competitive in the world, and one of the most productive. We believe in the allocation of assets by the market place. We think all industries should compete in the market place on an equal basis and that decisions should be based on sound business and economic reasons and not on tax reasons. We believe that would be in the greater public interest and would promote a more viable and efficient economy for all.

We strongly support the proposed corporate and individual rate reductions. The proposed reduction in the corporate rate to 33% and the proposed retention and improvement of the graduated rate for small business are, therefore, of absolute prime importance to our industry. Like wise, the reduction of rates for individual taxpayers is a prime objective. High rates spawn pressure for exceptions to favor one group or another, or one industry over others. This has contributed to the existing present-law situation of wide variations in the effective tax rates as between industries, and as between individuals, although they may have approximately the same economic income. Thus, in this context, any diminution of the proposed reduction to 33% in the corporate tax rate would be of great concern to the retailers. In particular, changes in other components of the Treasury proposal relating to business which would lessen this rate reduction would be viewed as reason for the retail industry to re-evaluate seriously its support for a reform package.

We strongly support relief from the double system of corporate dividends paid to shareholders. In this context, we viewed with great approval the provisions in Treasury I for a deduction of one-half of dividends paid to shareholders, and we were disappointed to see that the President's proposal reduced the 50% to 10%. As you develop a Committee bill, if you make major changes in the business provisions of the President's proposal, we strongly urge that you restore the deduction for 50% of dividends paid. The food industry has a history of paying a significant portion of earnings to shareholders. Double taxation of these dividends puts companies which pay dividends at a disadvantage relative to other companies that don't have such a dividend policy and, of course, puts equity financing at a disadvantage compared to debt financing. When corporate profits are taxed at the corporate level under different effective rates, depending on the tax situation of the particular corporation, and then taxed at the individual level at different rates, depending on the individual situation, the widely different total rate on this source of income is evident. We view relief from this double taxation as a critical component and an extremely important part of any package. Such relief should lead to increased business investment and should generally strenghthen corporate finance and certainly promote fairness and equity.

A component of the President's proposal of particular importance to all retailing, and especially small business, is the indexing of inventories. The use of an indexed FIFO method and the repeal of theLIFO conformity rule are very significant improvements. The food marketing industry is "inventory intensive" as well as labor intensive. The existing unindexed FIFO method imposes a penalty in times of inflation. Because of the LIFO conformity rule, and because of LIFO complexities, many small grocery firms still use the FIFO method - at least two-thirds of the total, according to Treasury and have thus been penalized during the recent inflationary economy. Thus, the proposals to index FIFO and repeal the LIFO conformity rule are important changes we support.

However, we would point out that the implementing details of the President's proposal are not included in the printed document. It has been our industry experience that this is an exceedingly complex subject in terms of the mechanics. We were advised by Treasury that the details would be left to regulations to be resolved. We urge strongly that this not be left completely to the regulatory process but instead general guidelines be set out specifically in the statute.

In conclusion, members of our industry recognize their responsibility to pay their fair share of taxes as members of the business community. We support the President's tax proposal as an overall and complete tax plan. We believe that to be effective, a tax reform bill must be viewed in totality and not in separate unrelated sections. Some provisions of the proposal will have the effect of increasing the taxes of some of our members in the short run. However, they have expressed their willingness to bear this cost in order to get a system that will be more equitable for the longer term.

Senator SYMMS. Well, I thank you very much, Mr. Brennan. You haven't been able to be here, but this is the wrap-up of the first 2 days of these hearings, and to date every single witness that's been posed the question has said that they think the Congress ought to be working on cutting spending as a priority.

Now, there have been a couple of them that said they thought we would do both. But to emphasize, what we're just saying—because right today every single taxpayer in the United States has to pay $650 to service their share of the national debt, so your family of four out here that they always talk about would be your market that you're out after, this young family living out here to go to the retail stores, they have got to come up with $2,500 every year just to pay their share of the interest on the debt.

If we continue to spend money at the rate we're spending it and piling the debt upon debt, we will end up with $1,000 per person in about 4 or 5 more years. And pretty soon it will be $2,000, and you'll have a whole generation of people out there, if you aren't lucky enough that your grandfather had a bunch of Treasury bonds and you can clip the coupons; you'll be just a slave to paying the interest on those things.

And the Government won't have money to do anything like, you know, something as mundane as defending the country; there won't be any money for that, because we'll be paying everything for interest.

And I say to my friends that tell me the deficit doesn't matter, if it doesn't matter, let's do away with all the taxes. And we could go on 100-percent borrowing and see how far we could get.

You and I know it wouldn't last very long if you did that. There would be no confidence left, and then the printing press would be discovered by the public. And we would be forced to make this decision. But right now we're in a real box on this.

But, now, I want to come back and ask you—and I appreciate your support for this bill. And I have had other people say that they're in favor of the tax reform proposal.

But you don't have any objections, do you, to some mitigating tax preferences that are in the code that protect jobs of people in the natural resource industry whether they're in Idaho, New Mexico, or wherever. I mean, that's the point I'm getting at. We're working on an assumption of static numbers. The bureaucrats at the Treasury and the Joint Committee on Taxation that do the computation of these things, they will not give us a dynamic model of what people's behavior will be next year.

So every time you want to preserve something, they say, "Where are you going to raise taxes to pay for them?" Of course, I reject that as a basic—I just think they're wrong in their computation, and I think they're wrong if they want to get fairness and equity and simplicity in the Tax Code, because you can't get from here to there.

But I don't see how we in Idaho can stand by and watch the companies that are big employers in natural resources curtail employment opportunities for people. That's not going to help a retailer.

Do you want to answer——

Mr. BRENNAN. Yes.

Senator SYMMS. Do you hear my question?

Mr. **Brennan**. I certainly do. I live it. And this isn't the only area that we find ourselves coming and going, and I wrote that down when you presented that question a few minutes ago.

It's not easy. You're a Senator who represents—even though it's a relatively small populated State, you represent a very diverse group of industries, and so do I, as the association's secretary.

I have retailers in St. Maries, Bonners Ferry, Kellogg, and Wallace that are members of my association and on my board of directors.

So I do meet myself coming and going on this issue, on unemployment insurance costs, to where it's distributed, on import quota bill. And I sit down with my friends from the logging industry, and we have been able to work out some reasonably good compromises; thank God we have some control over unemployment insurance and it hasn't all been given back to Washington as long as we don't have deficits, as long as we can balance and have the reserves to pay the unemployment costs. We still have control over that, and we do a much better job than they would do, than if that were in the control of Washington and the Federal Government.

The same thing is true of import quotas; I meet myself coming and going. Our industry is opposed to the import quota bill, Senate bill 680.

But I find myself talking to a retailer in St. Maries, who has a whole bunch of past due accounts receivables because his customers are laid off because the lumber mill is closed because of imports from Canada and other—and other things.

And I find myself coming back and saying, "What do you feel when I say to him about import quotas?"

I know this same thing exists with this legislation. It's not a black and white issue, and we—I guess we hope that in your best judgment you'll do—you know, you're not God, and neither am I, and it's very difficult to make that decision.

I represent and respect your position considering those natural resource industries, because my retailers are dependent on them in north Idaho, totally. They won't do any business if there's nobody working in the logging industry in many of those communities.

So we're very concerned about that. This isn't any different than what we deal with at the State legislature; very little legislation is black and white. Finally you have to make a decision and cast the vote.

I think it's great that you're out here asking and visiting with us about it.

Senator **Symms**. Tim, thank you very much.

Don, I appreciate it. Did you have any other comments?

Mr. **McMannis**. Let me make one more comment.

The food industry is an industry that doesn't have a very high net. I'm sure you're familiar that our net is somewhere between a half to $1\frac{1}{2}$ percent. On the average, about 1 percent of our volume ends up as a net.

So you can see that taxation in the neighborhood of 45 or 46 percent——

Mr. **Brennan**. Forty-six.

Mr. **McMannis** [continuing]. Effectively really cuts in. And it's difficult. There's a lot of competition, and we can't—we just can't raise our prices to make up for a high taxation. And it makes it very difficult for an industry such as ours with a high taxation.

We think that we are an industry that uses our labor and uses our resources well. We have to, or we won't be in business.

But taxation is eating into us.

Senator SYMMS. OK. Well, thank you very much. Your entire statement can be part of the record—I didn't mean to cut you off.

Mr. McMANNIS. No; you didn't at all.

Senator SYMMS. In other words, the 33-percent tax rate to a grocery retailer paying 46 percent now is a very—is a much more important tax break than some other thing?

Mr. BRENNAN. Absolutely.

Mr. McMANNIS. Very significantly.

Senator SYMMS. And I can see that, and I know that I have talked to some of those people in the food and grocery manufacturers who feel the same way in some of their things, and we haven't heard from some of our potato processors here how their view of this thing is. But we will get that information, because I do think it's important. And I do think that people are kidding themselves if they think that they can reform the Tax Code and solve all of these problems without ever getting a handle on spending, because otherwise, the money just runs out the door faster than you can bring it in.

Mr. McMANNIS. I was interested to hear you say that you believed anything over 50 percent was confiscatory. I would say——

Senator SYMMS. Well, I've introduced a bill that's a 19-percent rate, and I think that's too high, but——

Mr. McMANNIS. I was going to say that I thought, you know, maybe that that's a little high, that 50 percent is even high.

Senator SYMMS. Fifty percent is too high. That's the thing the President really deserves commendation on, is the willingness to go out there and take the steps to lower the rates. I would just like to see him start lowering the rates every year by two or three percent, and leave everything else alone.

I'm not convinced they wouldn't have more revenue anyway.

Mr. McMANNIS. But, Senator, I'm concerned that the Congress won't cut down on the spending, as in the last bill.

Senator SYMMS. It's interesting every year you get more money in the Federal Government. But you never hear them talk about that. There's more revenue that comes in every year.

Mr. McMANNIS. That's true.

Senator SYMMS. The revenue is coming in. With the 1981 tax bill and everything else, the revenue is still coming in more every year to the Federal Government, not less.

Mr. McMANNIS. Every program is funded higher than it was the year before, too.

Senator SYMMS. That's right. That's what's wrong. That's the problem.

Mr. BRENNAN. May I make one more comment, Senator?

Senator SYMMS. Sure.

Mr. BRENNAN. I have discussed over and over the waste in government with people—I was discussing this with one of my major store managers—owners and managers. And I was talking about what government does when they need more help or if there is a shortage of revenue, if they just go after more budget and the amount of waste is extensive.

And he said, "Do you know that when I have a department in my store that tells me that they have an adequate number of employees, I know they're overstaffed and we start cutting."

And heaven forbid that never happens in government. But that's what happens in private enterprise.

Senator **Symms**. That's right. Personnel costs is the biggest single cost and most people working in the Federal Government would probably like their job better if there were less of them around so they wouldn't be in each other's way. And the more bureaucracy—this just generates paperwork and costs. There's no end to it. And I'm convinced that's the case. So we haven't got Congress ready to do it yet, but I've not given up on that, that it still won't happen.

Thank you very much.

Mr. **McMannis**. Thank you, Senator.

[Whereupon, the panel members were excused.]

Senator **Symms**. We have had all the witnesses that are on the list, and I want to call forward a few people that say—we have what we call the open mike, so if there is anybody out there that wants to testify, come up and take a chair. And I think, Herb, you wanted to come up. Come on up. And Gene Winchester.

And what I'd like to have you do is write your name and address on one of those pieces of paper so our reporter will have it down for her records spelled correctly. And then identify yourself when you start.

We wanted to have this hearing over by 1 o'clock. So we're getting a little past our time. But I do think what you have to say is important to us, and I would like to hear from each of you, so I hope you can make your one point as concisely as you can and as brief as you can.

[Whereupon, the panel members assembled.]

Senator **Symms**. So I'll just start down the list here.

We'll hear from Gene Winchester first, and we'll go right on down the list.

STATEMENT OF GENE WINCHESTER

Mr. **Winchester**. Thank you, Senator. I'll be real brief.

I just wanted to say that I do support the tax reform. I feel it's long overdue.

And I'd give you a personal example on what it is for someone like myself who is a farmer and has a retail small business and part-time income from the State legislature and as a subcontractor. I go down to the Federal building, and I start at the rack and I pick up several forms of about every form they've got there.

And then I go home and lock myself in my little room for about 3 days wading through all the forms and computations. And before I ever start the process, I feel I know pretty much where my tax liabilities are going to be, because I have a large mortgage, and I have 11 dependents. I pay 10 percent to my church.

So I can reduce that quite quickly, yet I have still got to spend hours and hours and hours wading through a stack of ridiculous forms to satisfy only the Government. It doesn't do me a bit of good to wade through all of that paperwork.

One problem I feel in the various proposals you have to compare, including the President's, is that I would like to see it go to a flat tax, more of whether it's 10 percent, like the Siljander proposal. I don't know where that is and how many sponsors are still alive on that measure, but something like that. Whatever that percentage is, I think, should be the same for everyone.

And I think that's a fair incentive for people to gain from their ability, and it would probably bring in more money total.

I think that the mortgage preservation should be preserved and the charitable contributions preserved. The rest of it I can support, and I can support one that has those features in it. And I do that not for my selfish point of view, but I think for the homebuilders, that industry which relates to all our resources and timber, that we need to do that at least on the primary residence.

And for the charitable contributions, I think it's necessary because I'd sure rather see churches and individuals do it than build another bureaucracy and have government do it, which most of it wouldn't get down to the people.

And I think a lot of people have addressed the budget and the Government spending, and I appreciate your responsibility and your vote, but I think if you look over at your bar graphs, you'll see all the wrong ones going out the top right-hand corner. And the one on business profitability, which should be going out the top right-hand corner, is falling off the bottom edge of the chart.

And that's our problem is, people back there aren't limiting their spending.

And finally I would say that I hope this isn't a guise to raise more money wherever we finally set the rates. I know every time we've had one at the Idaho Legislature, of a tax reform or anything else, when all the totals were in, it was a heavier bite on the taxpayer. And there is that danger here, and I hope—I'm confident that you'll watch it wherever it settles down so it won't hit the taxpayer hard.

But it ought to be more simple and less.

Senator SYMMS. Thank you very much.

Grab that mike.

And we'll get back to you at the end, Herb.

STATEMENT OF TOM BLASINGAME

Mr. BLASINGAME. Senator, I appreciate the opportunity to talk to you this afternoon. And my name is Tom Blasingame. I run two small businesses; one is a construction drafting firm that services powerplant construction companies.

And, as you know, in 1980 the powerhouse business was about $2.4 billion, and in 1984 it dropped to $0.4 billion, so you see that that business isn't doing real red hot as far as the clients we have available to us.

The other business is a development company to design and promote modular truck equipment. And I don't want to go far afield except to say that we have proposed a system of modular truck equipment to the military, which I don't hold out much hope of seeing come to pass because there's a great resistance to working with privately developed concepts, and also our resistance to cutting down the amount of money that they have available for certain equipment.

But the real reason that I wanted to visit with you today is, I'm concerned about the investment tax credit. It might not appear in the new tax reform package. The problem that I have in letting this pass is, the customers that we would have for commercial applications over truck equipment—for instance, having a strong inclination to run that equipment until it drops. They'll take a truck and they'll run it for 5 years, and if it will run any further, they'll run it as long as they can.

They have had in the past an incentive through the investment tax credit to replace some of that equipment, which to my understanding is that this investment tax credit wouldn't be part of the package so they won't have that incentive.

It doesn't just apply to the truck market. It applies to the industrial market. And the big problem with eliminating the investment tax credit, of course, has to be that no one has an incentive to replace the obsolete equipment that they have to fabricate the equipment.

Right now we could go to Korea or other Asian countries and get prefabricated parts made in that country and shipped back to the United States for less money than we can have them made here in Idaho. And if we don't want to lose the tax base to feed this growing tax giant, we have got to maintain the capability of manufacturing that equipment.

Once that manufacturing facility falls over and dies, it's never going to come back. You can see it in the steel mills, you can see it in the large fabricators.

I know one company that has three facilities in Salt Lake, two of which are shut down, heavy steel fabricators. Part of their problem is the imports. The other problem is that they are not getting an equal tax advantage to other industries.

I think there is an advantage built in for high-tech industries. I think the smokestack or the heavy industry is the bad guy in the economy. And I can't see giving away a viable industrial base just to satisfy the vested interest groups that might appear in the banking industry that have made a lot of bad loans overseas and now we have to give our industry to the overseas people so they can pay those loans off.

The problem that we have is, we have got to maintain a capability of producing this manufactured product. And once we lose that industrial base, we're absolutely at the mercy of any other industrialized country in the world or any developing country.

Senator SYMMS. Thank you very much.

Just pass the mike right over to the young lady there.

STATEMENT OF SUSAN EASTLAKE

Ms. EASTLAKE. My name is Susan Eastlake. I'm a CPA here in Boise.

Senator SYMMS. Welcome to the committee.

Ms. EASTLAKE. Thank you for allowing us to testify.

I have two points that I would like to make. First of all, I worked for the IRS for 5 years as a revenue agent before beginning private practice as a certified public accountant, and I have been preparing taxes—income taxes, primarily—for about 12 years since that.

In the last 2 years, it has become apparent that the most important thing Congress could do for my clients is to reduce their income tax burden.

I see women who are divorced, age 55, 56, people who are retired buying tax shelters which are very poor economic investments, and yet they feel that they're paying a disproportionate share of this country's tax burden.

And so they're out buying these investments they should have no interest in, let alone have their dollars invested in.

I think it's a psychology that says, "I'm paying more than my share," that's causing these people to be looking and listening to that kind of tax—that kind of investment rather than putting their money into a secure, reasonable return type of an investment. I think reducing that tax burden is critical.

I have a problem, however, with only looking at income taxes when I see that the small business owners for whom I am doing taxes pay 14 percent of their pretax income, or will very shortly, in Social Security taxes.

Social Security tax has also been used or is currently being used to carry what I perceive to be some of the welfare burdens of our economy. It's used not only to fund retirements; it's used to fund disability payments, to fund dependent children, care for people who become diseased.

I feel that when you are really looking at a fair and equitable tax, you have to look at whether or not those are not burdens that ought to be borne by the entire tax system rather than the Social Security system and perhaps allow our workers to pay a lower Social Security rate, perhaps at the expense of the entire income tax system being slightly higher.

To me, it is unfair to tax workers on their earnings at a higher rate than you tax income from capital. It never seemed fair to me that a person who could afford to invest their money and live off of earnings should pay less tax than a person who has to work for their earnings.

The second thing I'd like to speak to is simplicity. My personal belief is, more than half of the taxpayers in this country should not have to hire me or anyone else in order to determine what is their most beneficial income tax liability.

Many people can prepare their own income tax returns. They don't do it. They bring them to me and others like me because they think I know more than they do and can give them a better bottom line.

That's not right. People should not have to hire a professional when their only earnings are from wages and, you know, maybe some small investments.

And I believe that complex businesses and investors can afford to hire me and, therefore, their tax law could indeed be much more complex.

The simplicity should speak to the majority of taxpayers who don't deal in complex issues.

Those are the only two subjects I'd like to speak to. But I would like to mention one other thing.

I'm a commissioner on the Idaho Housing Agency, and I have been with the agency for about a year. And I would like to disagree with speaker Stivers. He indicated that he didn't feel the Idaho Housing Agency had an appropriate role and that retaining tax exempt status for housing bonds perhaps is not a legitimate use of the Tax Code.

But particularly here in Idaho we've seen over the last few years, when interest rates were high, that the only money available for the housing industry for construction and real estate industry was money that was made available by Idaho housing, because the interest rates were substantially lower than the market rate. And we had kept, by allowing Idaho housing to float tax exempt bonds, we provided financing to industries which otherwise would not have had one.

Senator Symms. Thank you very much.

I might note that it appears right now that the Social Security trust funds are starting to run in surplus. And 1988, as you are aware, is scheduled to be a big tax increase on the FICA taxes.

It's my hope that by then we can do away with that and possibly even reduce the Social Security taxes a little bit because they are starting to build an enormous surplus. Whether that will continue remains to be seen in the future, you know, what the employment is and what the economy is in general. But it looks like the people are being taxed more than necessary at the present time on Social Security.

And certainly if Social Security got moved out of the unified budget, it would make a lot of sense to reduce those taxes because there would obviously be the problem on the other side of the equation, that then the budget would look worse than it does now, if there is, in fact, a surplus.

Pass the microphone, please.

Sir, please identify yourself.

STATEMENT OF WENDELL PHILLIPS

Mr. Phillips. I'm Wendell Phillips.

Senator, I think the whole problem with setting income tax law is, when is income income, and when isn't income income?

I think that's your whole problem. There are so many loopholes that have been designed into the tax system that, in effect, State income is not income.

And there are also exemptions to the income tax law that says the money we spend for personal deeds is not income, the money we give to churches is not income, the money we give to charitable organizations is not income.

So I think you're going to have to start back and look basically at when income is income and when it isn't. And I think the least deviation you make from that, the better the nation is going to be in equally distributing the income tax load.

Senator Symms. Certainly that would be the way to get a lower rate.

Mr. Phillips. Yes, it would. And I think, just for instance, just on personal exemptions, if you have two people like I do, you have a certain amount of exemptions. If you have 10 people, you have 10 times—or 5 times that much.

In essence, it's income, regardless of how we spend it. The same thing with contributions to churches, same thing with contributions to charitable institutions.

Thank you.

Senator Symms. Thank you very much.

Pass the microphone, please.

Mr. Crim.

STATEMENT OF JOHN CRIM, VICE PRESIDENT-TREASURER, MOORE FINANCIAL GROUP, ON BEHALF OF THE IDAHO BANKERS ASSOCIATION

Mr. Crim. Senator Symms, thank you for the opportunity of being able to present this today. My name is John Crim. I'm the vice president-treasurer of Moore Financial Group, and I am representing the Idaho Bankers Association.

You have a letter that you have in your possession.

Senator Symms. Right. Thank you.

Mr. Crim. And I applaud the efforts——

Senator Symms. First, I'd just ask unanimous consent that the entire letter be printed in the record.

[The letter follows:]

IDAHO BANKERS ASSOCIATION
BERNE K. JENSEN
Executive Director
Idaho Bankers Association
P.O. Box 638
Boise, Idaho 83701

OFFICERS
President
L. SCOTT NELSON
Boise
First Vice President
JAY L. NIELSEN
Burley
Second Vice President
JAMES BURUM
Boise
Treasurer
R. JAMES MEIKLE
Idaho Falls
EXECUTIVE COUNCIL
DAVID M. EDSON
Boise
EUGENE D. HEIL
Boise
V. DALE BLICKENSTAFF
Boise
ANN NEAVILL
Kuna
MAHLON S. PARK
Boise

August 12, 1985

Senator Steve Symms
State of Idaho
Room 338
304 N. 8th
Boise, Idaho 83702

Dear Senator Symms:

The following are comments relative to the President's Tax Reform proposal from the Idaho Bankers Association, an association representing all 25 Idaho banks. We appreciate the invitation to offer these comments for your consideration as a member of the Senate Finance Committee.

We will attempt not to be negative toward the overall proposal as we applaud the effort to make federal taxes lower, simpler and more fair. We generally approve the new Code's cash to accrual requirement for large banks, the changing of the next operating loss carry forward period, the statutory tax rate reduction, the dividend policy deductibility and favor increasing the IRA amount that can be deducted by individuals.

We do have two major objections to the package that specifically affect banks. The first is in the area of loan-loss reserve and charging deductibility of losses only when incurred. For every loan that is made there is an inherent risk and a potential loss that under accrual accounting should be recognized. In Idaho we have found this particularly true in recent times, as Idaho banks are incurring an extraordinary amount of write-offs of bad loans. Further we believe that not establishing loan reserves is contrary to the regulatory safe and soundness doctrines under which all banks operate, whether they be federal or state.

Our second objection is to the perception that banks do not pay their fair share of taxes. Public policy has created laws for the benefit of the Federal government, municipalities and banks have been designated as the source to handle these policies. The current IRS Code is designed to assist municipalities in their financing needs and to limit the subsidy necessary from the Federal government to permit state and municipal financing to be done tax free.

Banks buy and hold municipals at no real earning benefits, but do receive a tax advantage. Additionally the Federal government makes a substantial amount of money on reserves deposited by banks with the Federal Reserve. When these two areas of public policy are tax effected, the banks actually pay better than the 46% rate the statutory rate of federal taxation.

If the public policy is changed disallowing interest on municipals as exempt then the banks must charge full taxable interest on those obligations. This can be done if it is intended that the public policy should be changed, but it is unfair if existing tax exempt municipals are excluded. Subsequent trading of these securities could severely curtail the liquidity of financial institutions. Fairness would dictate that the tax legislation would not affect investments made prior to the enactment of new legislation.

There are other comments which can be made that affect all businesses, but we feel confident that these concerns will be covered by others, and conclude by expressing the hope that you will consider the above two specific objections to the tax proposal as they affect banks.

Very truly yours,

V. Dale Blickenstaff
Immediate Past
President, Idaho
Bankers Association

Mr. CRIM. Thank you.

In recognition of the time you're trying to get out of here, I'd just like to point out two things that are in that letter that I think are important.

While we do think that the efforts of the Federal Government in lowering taxes, making them simpler and making them fair, are appropriate, we do have two major objections to the package as it presently is being proposed.

The first of that is in the area of the loan loss reserve and the charging deductibility of the losses only when incurred. It's very contrary in our belief that if you are requiring large organizations such as financial institutions to be on an accrual method of accounting, that the IRS proposes to make loan loss recognition on a cash basis. This will require the financial institutions that are required to be under accrual accounting to maintain two sets of books: one for the generally accepted accounting, and a second set for the tax records.

It also is contrary—the position taken by the IRS is contrary to the normal regulatory requirements of the various federal and state agencies for safe and sound banking to have loans written off—the final point that they're a loss as opposed to loss recognition as that loss is occurring on an accrual basis.

Our second objection, again in the area of fairness, is the perception that banks do not pay their fair share of taxes. Public policy has created laws for the benefit of the Federal Government and municipalities, and the banks have been designated the source of, if you will, handling those policies.

The current IRS Code designates that to assist municipalities and their financing needs and to limit the subsidy necessary for the Federal Government to make to permit those municipalities and State agencies to have the necessary financing, there's a subsidy that's provided. And banks provide a subsidy in the effect of tax affecting the interest rate required of municipalities.

We have no objection to the fact that new exempt issues that would be issued by municipalities be at a fully taxable rate and that the banks that would be participating in those underwritings would pay taxes to the Federal Government for that particular subsidy, and we would then, in turn, charge it to the municipalities.

Again, if you take a look at that particular statute, there are millions of dollars that are currently outstanding that are tax exempt. And the new proposed Tax Code needs to recognize that for the liquidity that is necessary for financial institutions, that there has to be some grandfathering to permit a secondary market of the exempt issues that are already out there to be traded on a fair and equitable basis, not paying taxes on them.

In recognizing the benefits that financial institutions provide to the federal government, I would also point out that all Federal Reserve banks have substantial cash reserves on which they receive no earnings that are to the benefit of the federal government. In taking the Federal Reserve Bank's own reports and deducting all of their expenses and recognizing the earnings that they gain on those reserves, and further taking the subsidy that is provided in municipal exempt obligation financing and adding that to the effective tax rate that banks pay as a whole, in 1982 it was shown that we paid in excess of the 46 percent Federal statutory rate.

And I think there's plenty of legitimate documentation out there, if you'd like to have it, that supports those numbers.

I thank you very much for the opportunity of being here today.

Senator SYMMS. Thank you very much.

John, I want to ask you one question that maybe is not a fair question, but isn't there a great deal of similarity between loan loss reserves and the way you can account for it in the bank on the accrual basis, setting some aside to predict what the losses might be then in an insurance company, that in casualty and property insurance they set aside some money, the Treasury is proposing in this same bill to attack them in the same fashion they are with the banks, and that is to say that they have to pay—they can't charge off the deduction on the insurance payouts that they make on property and casualty until they take place, so they tax them on the money that they set aside to pay off the claims with, in other words. Is that a similar situation?

Mr. CRIM. I don't think so, Senator, necessary that it is. When we make a loan to one of our customers, there is an inherent risk that is there that we are, in fact, charging for and setting aside those funds that we have not received.

Senator SYMMS. What is the loan loss rate right now? Is that 1 percent or something?

Mr. CRIM. It's dependent upon the risks that's in the portfolio. In our particular institution, it's about one and a quarter percent.

Senator SYMMS. Well, I mean, what's allowed to be deducted?

Mr. CRIM. Well, it's on a 5-year moving average of actual losses incurred. And I would support that that type of application for tax purposes is a very acceptable one, and it should be continued as opposed to saying until the loss is a total loss, that none of it can be deducted.

Senator SYMMS. OK. Thank you very much. I appreciate your testimony.

[Whereupon, a discussion was held off the record.]

Senator SYMMS. Yes; I think that's an important point.

John, I may want to ask you one more question.

I have a feeling that what the Government wants to do is, they want to get you to pay the taxes in advance——

Mr. CRIM. That is correct.

Senator SYMMS [continuing]. Because they're so broke. And it's the same thing they want to do with the insurance people. They want them to pay their taxes in advance, because they're so broke. They're trying to get people's money without having to pay the interest on the money.

In other words, they are taking away what we know is an important thing, is the time value money and who's got it because somebody has to pay for it. It's a commodity.

But it is that same principle. They want to get all that money away from you, and then after a year or two it might turn out that it would work out even, but in the front end it could squeeze your liquidities, is what you're saying——

Mr. CRIM. Absolutely.

Senator **Symms**. And jeopardize an already squeezed situation.

Would you please state your name, sir?

Mr. **Gestrabek**. Rudy Gestrabek.

Senator **Symms**. I thought we had the last witness up here at the table, but we didn't.

And I haven't got Herb over yet, either.

STATEMENT OF RUDY GESTRABEK

Mr. **Gestrabek**. Rudy Gestrabek is the name. I'm a retired farmer of about 50 years, and about 25 years of salesmanship for insurance and securities.

And I thank you very much for this opportunity.

And first, I also want to tell you that I appreciate whenever you vote the way I think you should, and I generally give you a pat on the back by telephoning to your office.

Senator **Symms**. Good. Well, thank you.

Mr. **Gestrabek**. If I disagree with your thoughts, I'll let you know by letter.

Today I want to express my thoughts on tax reform.

Senator **Symms**. Keep those phone calls coming. [Laughter.]

Mr. **Gestrabek**. OK. Today I want to express my thoughts on tax reform. We all agree that it's needed. And one thing that really does irk me pretty much is, I take a letter—subscribe to an investment advisory service. They repeatedly state that if you're paying more than $10,000 in personal or corporate taxes, you're paying more than you need to.

Then they go on and show how if you have $100,000 a year in the 50 percent tax bracket, you can invest $35,000 in an agricultural project and save $36,750 in taxes.

It's too complicated a procedure to go into detail here, but it shows how the wealthy can and do escape to pay what to us in the middle class seemed to be a fair share of paying for the cost of running our Government.

Now, what seems to me to be the best income tax form proposal that I have seen is to levy taxes on any person's or family's net—and I emphasize net income up to the currently determined cost of living without any other deductions except the interest payable on the mortgage on the principal dwelling of the person or their family uses as their home, and catastrophic expenses for medical expenses.

And after that, it could be a flat tax on all other income including Social Security, which would include me, without any other deductions or tax shelters.

Now, I didn't know about—you mentioned a while ago that Stanford has suggested a tax similar to——

Senator **Symms**. Hoover Institute.

Mr. **Gestrabek**. I beg your pardon?

Senator **Symms**. The Hoover Institute.

Mr. **Gestrabek**. Oh, the Hoover Institute. I understood it was Stanford.

Senator **Symms**. Well, they're at Stanford University, but it's a separate institution.

Mr. **Gestrabek**. Oh, I see. What is the reason that this doesn't seem to be acceptable? It would——

Senator **Symms**. It makes so much sense.

Mr. **Gestrabek**. Excuse me. It would eliminate most of the problems that these people have brought up.

Senator **Symms**. Well, we have some witnesses at the—they're going to testify. I might just say that it's gotten some attention from Senator Packwood. He has sent one of his top people down to a seminar to study it, the two economists that wrote the bill, Hall and Rabushka, are going to testify before the Senate Finance Committee.

Parts of that principle have been included in the Kemp-Kasten bill, but it still basically is the only flat tax proposal that's before the Congress that would do away with the bias against savings that is what has created all the necessity for the current tax system the way we have it today. Because when you double tax the person's savings and you allow an interest deduction, you're starting off with a situation that has created the necessity for everybody to come in and say, "We need a break for this; we need a break for that so we can have energy independence and some of those things."

And that's how it all happened. It wasn't necessarily—on the other side of it, if the Government stopped spending money, you wouldn't have so much pressure, and you wouldn't need so much revenue.

I didn't want to cut you off. But I'm trying to close this hearing.

Mr. **Gestrabek**. I'd like to add just one more thing——

Senator **Symms**. OK.

Mr. **Gestrabek** [continuing]. In regard to corporate taxes.

If we had such a tax system, would we need corporate taxes? You have mentioned many times that corporations do not pay taxes. They collect taxes, and I agree with you.

Senator **Symms**. People pay them.

Mr. **Gestrabek**. Right. The consumer does in the end.

Senator **Symms**. That's right. But, you see, this is the thing that's disappointing to me, to have a conservative President who said that all his political life, comes out and introduces a bill that the basis of the bill is to reduce tax rates on individuals by passing the taxes back in the form of hidden taxes back on the business, corporations.

And in some cases maybe those businesses can correct the taxes and pass it back to the Government, but in the case of some of the major employers in Idaho, they don't have anyplace to collect it because they sell into an international market.

And I think that they have created a situation here where they may find out that they don't have a vote for their tax reform bill out of the whole Rocky Mountain region. I'm not sure, and I can't speak for the other Senators. But the way they're going at it, I believe they're creating an impossible situation. And it makes this whole discussion an illusion instead of something that we should really be trying to do, is to make our tax code fair and equitable.

Mr. **Gestrabek**. Right.

Senator **Symms**. But I thank you very much.

Mr. **Gestrabek**. I thank you.

Senator SYMMS. Mr. Herb Carlson, Idaho State senator, we're going to hear from you, and you'll be the clean-up witness.

STATEMENT OF HON. HERB CARLSON, IDAHO STATE SENATOR

Mr. CARLSON. Thank you, Senator.

Unlike those who have appeared here earlier and stated how pleased they were to speak before the august body, I'm glad to be here in August to have this experience. And it's a new opportunity for me.

Just a few words. I'm going to leave with you a little document that identifies 16 specific items, and I'd just like to amplify a very few of them.

Under the reduction of record keeping and the complexity of the present tax codes, before the last simplification, I have always done my own tax returns.

Senator SYMMS. Before the last simplification?

Mr. CARLSON. I have always done my tax returns, but before the last simplification it only cost me $125 to take it to the CPA experts to see that I have included everything and done it correctly. And after that simplification, it now costs me $300.

So I guess my remarks about reducing record keeping and complexity, I agree with all of the items listed under 401, 402, 403, 404. When it comes to repealing income averaging, however, I'm opposed to that because this is a definite advantage for an individual whose income would fluctuate dramatically occasionally.

And I had that experience here quite recently when I was given an inducement by a significant firm here in the area to take early retirement.

So I certainly am opposed to repealing the income averaging. I think it's a fair process and it should remain.

As to simplifying penalty provisions, I'd agree with that. A simplification of the penalties on returns should be made.

But I do not agree that there should be a repeal of the maximum limits on the penalty; rather, the taxpayer may have a tax change due to an audit that could result in a penalty, and if an upper limit were arrived at, that would prevent the IRS from financially destroying one or another taxpayer.

As to replacing the failure to pay penalty with a cost of collection charge, I'd agree with one exception: If the taxpayer is on a payment schedule, there certainly should be no cost or collection charges assessed.

Now, one of the simplification ideas is to implement a nonfiling system which the IRS would compute taxes for many taxpayers. Frankly, I would be opposed to that because it's a—it leads itself, in my opinion, to the possibility of a dictatorship.

Senator SYMMS. What's that point again?

Mr. CARLSON. That's the point where, under item 5, simplifying the system of filing, to implement a nonfiling system in which the IRS would compute taxes for many, many taxpayers. I would certainly be opposed to that. That would give them, in my opinion, altogether too much power. And it seems that they have more than enough right now.

Now, I'm not going to go on with any of these other items because they can be read at your leisure and by others. I just want to firmly support the comments that were made by my CPA acquaintance when she spoke about the Idaho Housing Agency and the good it's done with the single-family loan arrangements.

It's not a gift. It's not free. But it's a system whereby many folks now own a home where they couldn't, in the State of Idaho particularly.

I also want to say I stand definitely on—as far as Social Security, for it to stand alone, let's get it out in the open. Let's get it out of the unified budget so that these people who are retired and are depending on Social Security can be relieved of all the harassment that they seem to get, in my opinion, from unscrupulous politicians that are continually harpooning about the fact that there isn't money there.

There is plenty of money there if you ever get it out and let it stand alone so that people could see it.

More than that, I would certainly embrance any kind of a bill that would eliminate the bias against savings. And that would be a step in the right direction. And I hope—in your hearings as you go around the state, I hope you would admonish those in the special interest groups that—it's a unique system that we have in the United States. And it's right and proper for all of those special interests to stand up and be counted so that they get fair treatment.

But let's not let that deteriorate into special favors. I hope that all of them will stand up and be willing to pay their fair share while they are impressing upon you the need for some special treatment.

Thank you very much for listening.

Senator SYMMS. Thank you very much for an excellent statement.

Now, I've got one last witness. Is there anyone else that wants to submit written testimony? We'll keep the hearing record open for you. But this will be our last witness.

Thank you. I appreciate very much all witnesses today.

Mr. CONNORS. Thank you, Senator Symms. I'm sorry I got here a little late.

STATEMENT OF JOHN CONNORS

Mr. CONNORS. My name is John Connors. And I want to speak directly about the IHA, and I read in a recent press release that you were concerned that without programs such as IHA and assistance to people to buy homes, that rental prices would go up quite possibly because more people would be pushed into that marketplace.

Senator SYMMS. I'm also concerned about the section of this bill that affects people's ability to build apartments just in general.

Mr. CONNORS. Yes.

Senator SYMMS. We had testimony before the Senate Finance Committee in Washington where people testified they thought rents would go up—how much was it, Rip? 30 percent? 40 percent, something like that?

They had some numbers at 20 to 30 percent that they were saying they predicted that low income rents could go up.

Mr. Connors. Yes.

Senator Symms. That is a concern, I think. That's the thing I think we have to be cautious of in tax reform, is that in the name of reform, if we do something that raises rents on a large segment of our economy of people who are trying to get their savings together so they can buy a home, that that may not be as good of a reform as we would like.

But go ahead and please make your statement.

Mr. Connors. Sure.

Senator Symms. I have another meeting and I have to get out of here.

Mr. Connors. I just feel that the marketplace would be the best way to determine what the fair price is for rent and the subsidies such as IHA and accelerated depreciation on commercial office buildings really in the long run causes a misallocation of funds.

I think that if rents go up, the attractiveness of buying a home goes up. I think the marketplace alone should be what determines what rents should be, and I think that in a time when we all realize that there is a tremendous budget deficit, we should look carefully at whether we are allocating our resources well when going into IHA type programs.

That's basically all I had to say.

Senator Symms. In other words, what you'd like to have is a pretty level playing field in the tax code?

Mr. Connors. Exactly.

Senator Symms. Let the marketplace run it?

Mr. Connors. Exactly. Yes.

I also, parenthetically, would like to see a more closely defined capital asset treatment. In other words, right now for capital—to have capital appreciation, long-term appreciation, those sorts of benefits are open to a whole variety of capital assets including things such as collectibles—stamp collections, butterfly collections, if they're held for investment purposes, can qualify for preferential tax treatment.

I think that it would be more beneficial to the economy as a whole to more nearly define that into the types of assets that can produce jobs, the types of assets that really help our economy grow and not to have a broad spectrum of things available for long-term capital gains treatment.

That basically is all I have to say.

Senator Symms. Thank you very much.

The subcommittee is recessed until tomorrow morning at 9:30 a.m. in Idaho Falls.

[Whereupon, at 3:13 p.m., the subcommittee recessed, to reconvene at 9:30 a.m., Tuesday, August 13, 1985.]

BLANK PAGE

THE IMPACT OF THE PRESIDENT'S TAX PROPOSAL ON THE MINING, TIMBER, AND AGRICULTURE INDUSTRY

TUESDAY, AUGUST 13, 1985

Congress of the United States,
Subcommittee on Monetary and Fiscal Policy
of the Joint Economic Committee,
Washington, DC.

The subcommittee met, pursuant to recess, at 10:50 a.m., in the city council chambers, Idaho Falls Electrical Building, Idaho Falls, ID, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Joe Cobb and Dwight Ripley, professional staff members.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator Symms. The committee will now resume our hearings. This is our third hearing we've had in Idaho on the impact of the tax reform proposals on the economy in the State of Idaho, and I want to welcome all of the witnesses that are here and just give you a little update on what we've done so far.

We had a hearing Friday in Coeur d'Alene. We received testimony from some 25 witnesses I think; and then we had a hearing Monday, which was yesterday, in Boise and had about the same amount of witnesses from a very broad base of various employment industries in the State of Idaho. We've had witnesses from the mining industry, from the timber industry; and we're going to have more witnesses today from agriculture. We've had witnesses from agriculture yesterday also.

But we want to establish a hearing record of what people's impressions are and beliefs are and our best analysis of the situation of how the President's tax proposal and other proposals, but primarily the President's tax proposal, will affect the economy in the State of Idaho.

And in general, I think most people have stated that they favor the President's goal to mak our Income Tax Code more simple and conceivably more fair; and that there is a great deal of sentiment in the country that it is too confusing and too complicated. But on the other side of the coin, the witnesses have consistently stated that they thought controlling Government spending was more important than the tax reform proposals presently before the Congress.

Now, we have already found out that there are major amendments that must be put into this bill in order to make it palatable, in my opinion, with the viability of the employment situation in the State of Idaho. The mining industry has made, I thought, a very good case on the importance that they are able to preserve the depletion allowance because they're not making a profit under the current metal prices in the major mines in the State of Idaho today. There are thousands of jobs at stake.

And to remove some of those tax preferences at this point in time would make them further or less competitive than they are today, and they can't afford to be less competitive because they're not making any money right now. And if you take away a tax preference and put them in a situation where they have a liability, there is a chance that there could be more unemployment in the State; and we don't need that nor can we afford it.

And frankly, we'll talk about some—we'll talk about a lot of this bill for a long time as far as I'm concerned if we can't get these things changed in the Finance Committee when markup comes.

Now, I personally am of the opinion that this proposal is not going to move as fast as President Reagan would like to have it move, and I think the reason for it is it simply takes on every single natural resource-producing sector of our economy—agriculture, timber, and mining. And it also in Idaho—there's a part of this bill that addresses the second home mortgage deduction, and we heard considerable testimony about that yesterday in Boise.

So I think these are areas that I'm concerned about, and as I said at the outset, there's not one single person in the State of Idaho that is not going to be impacted by major changes with the Income Tax Code because we all are taxpayers and we all, either through our companies we work for or individually or businesses that people are involved in, are affected by changes in the Tax Code.

So there's no—no one escapes that, and it is of critical importance. And I think that we've had really very successful hearings, and I look forward to hearing from those of you who are here this morning.

Before we start with the first panel, I want to introduce Mr. Dwight Ripley who is here on my left. Rip is a CPA. I made the mistake of referring to him as an attorney yesterday, and he about came unglued. He's a CPA from Nampa who has recently left his firm, where he had a successful business for the last 30 years and is coming to Washington to work on my staff. And he has really gotten up to speed on what these tax proposals are and how they affect Idaho.

He's been doing mostly accounting for agriculture and small businesses in the Boise Valley, but he has a good grasp of what the other resources are and is working with the tax people. So if you have any tax people that you want about a technical part of the tax bill, Dwight is available to work with constituents in Idaho to help me be able to have a better understanding of what's at stake.

On my right is Mr. Joe Cobb who is an economist with the Joint Economic Committee, and I'm going to have Joe just take a brief second to kind of get us oriented on what's happening here in

Washington. The only chart we don't have is the one that shows the national debt.

And I just might mention that the national debt was $1 trillion 5 years ago. It's bumping up to $2 trillion now; and if we keep spending money at the rate they're doing in Washington, DC, it will be $3 trillion by the year 1990.

And I predict that we're going to have one whale of a fight in Washington when we return after the recess when the President has to come and ask for the debt limit to be lifted; and I personally, as one Senator, am hopeful that we can pass a very—some really strong budget reductions and put it on the debt ceiling and get it in a take-it-or-leave-it situation. But that remains to be seen. That's a note on the side.

But we don't have that chart; but having said that, Joe, you go ahead and take a minute there and just point out these charts. And then we'll get right on with the witnesses and get on with the hearing.

Mr. COBB. OK. This first chart here that we made up gives you a picture of what's happened to Government spending since 1976. In the last 10 years, Government spending has jumped from $400 billion all the way up, as you can see on this curve, up to the present level, which is above $900 billion.

Senator SYMMS. I might just point out, as Joe makes the point, that oftentimes you hear the national leaders--and I have talked to the majority leader about this a lot. They make the mistake, in my opinion, of referring to the deficit as the problem. The problem is that chart right there because, see, everybody always says they want a deficit reduction package. What you want is a spending reduction package because you can close the deficit by raising taxes.

We're closing the deficit right now by borrowing money. They fill the deficit all right. They just go out and borrow $200 billion, and then we have to pay the interest on it. But they're balancing the budget, and that's a point that I think needs to be made.

Mr. SCHMALZ [interrupting]. Bruce L. Schmalz, Idaho Falls, ID. The big part of that, though, is interest on the money that's already been borrowed.

Senator SYMMS. About $150 billion, yes, sir. And it's going to get bigger. It's $650 per capita in the United States. Every single person had to pay $650 last year. By 1990, if we keep going at this rate, it will be a thousand.

So that means this typical family of four that we always read about in the national magazines, the family of four that live in the suburbs and so forth of your Newsweek, well, they have to pay $2,500 a year just to service the debt. Well, if you get that in another 5 years, they'll be paying $4,000 a year.

So it's no wonder we've got a problem of people being able to pay their own bills. That doesn't pay for any defense or anything else. That just services the debt, and that's a real problem.

Go ahead, Joe.

Mr. COBB. In the spending increase, a much more rapidly growing part of government spending has been the so-called uncontrollable spending. These are the entitlement programs, the programs where Congress has defined a certain category of individuals and said "You are entitled to come to the Federal Treasury and take what is determined by formula that's available to you."

These are called uncontrollable spending because Congress doesn't even appropriate the money in any specific amount. It simply says, "We believe that maybe people will come and take only 100 million in this category this year." And it's uncontrollable. It's been rising at a much more rapid rate, as you can see, than spending in general.

This chart, third chart, is a chart of Federal budget outlays, and this—we want to give you a comparison between what has been happening during the last two administrations. President Carter in his last year submitted a budget for fiscal year 1981, and it projected spending up according to this dotted line.

As you'll notice, the program that Ronald Reagan put in has not reduced spending. It's only reduced the rate of increase in spending.

This fourth chart shows a comparison between government outlay and government receipts. The red line along the top is government outlays shown as a percentage of the gross national product. The blue line along the bottom shows government receipts as a percentage of the gross national product.

The famous tax cuts of 1981, as you'll see, reduced government receipts from about 21 percent of gross national product down to the level of 19 percent where they had been throughout this entire earlier period. But all of these uncontrollable spending programs have kept pushing government spending up now to 25 percent of the gross national product.

Senator **Symms**. Joe, I might just make a point on that chart also, and I think that's a very important chart. When I was a Member of the House, the first term or two I was in the House, well, Wilbur Mills was the chairman of the Ways and Means Committee. And Mr. Mills became famous for other things later, but he was one of the best tax experts in the Congress.

And he had studied the Tax Code and knew as much about it as anybody in Congress. And he had a theory that anytime that the income tax raised in a macrosense, went above 18 percent of the gross national product, that we had to reduce tax rates or give tax breaks, you know, something because he had charted—he had a staff man there named Woodworth that had charted this for 25 years. And every time the tax rates went above 18 percent of the GNP, you started having a lot of noncompliance.

And that's what people talk about, the underground economy, people not paying their taxes, avoiding it. And that's because the rates are too high, and they're too confiscatory. And people resist having the Government take everything away from them.

And I think that's part of our problem today. See, our spending is so high that if we raise taxes to pay for it, you just have more and more people objecting and resisting the tax system; and it makes it an impossible thing to enforce. And this is why we have countless problems of the Internal Revenue Service harassing the citizens of the country.

Now, Rip can give you a thousand examples where I can give you a few of, you know, just hard problems with the IRS and his constituents, his clients, who are honest taxpayers but who are just being harassed by the IRS because the IRS is under pressure. They've got the Treasury Department telling them, "Raise the money, boys. We've got a deficit problem here."

Well, see, if we cut spending, we wouldn't have this problem; and that's back to the myth of the year, as this vernacular and the use of the English language, to talk about uncontrolled spending. There isn't such a thing as an uncontrollable expenditure of the Federal Government. Anything the Federal Government, the Congress, grants authority to spend, why they can take it away.

The truth of it is that Congress hasn't got the cuts to take on the sensitive entitlement spending section of the Government, which is 50 percent of the budget, because it's too much of a political football. And every time that anybody mentions it, well, Tip O'Neill has another press conference and blasts the Republicans or somebody because they say they want to do away with Social Security or something.

And this thing is just going to keep on going until we get enough people in Congress that have guts enough to put the lid on this thing and stop increasing everybody's checks every 6 months or a year or two; and then we could get this back under control, do just what you'd all do on the farm or in the business when you get—where you've got more money going out than you've got coming in, you have to stop having so much help around.

Go ahead, Joe. I'm sorry.

Mr. COBB. The fifth chart on this wall shows what has happened to the profitability of business and agriculture since the early 1960's. The average business profit around 1963 was 16 percent; but there's been this long slide ever since then so that the average profitability now, if you're lucky enough to make a profit at all, is about 8 percent.

And this explains to a large degree the loss of productivity and the loss of efficiency in our industries; and much of it is due in fact to this long period here where taxes kept bumping up above the 19 and 20 percent level and that the Government spending, which takes real resources away from the economy so that businessmen cannot use those resources for productivity.

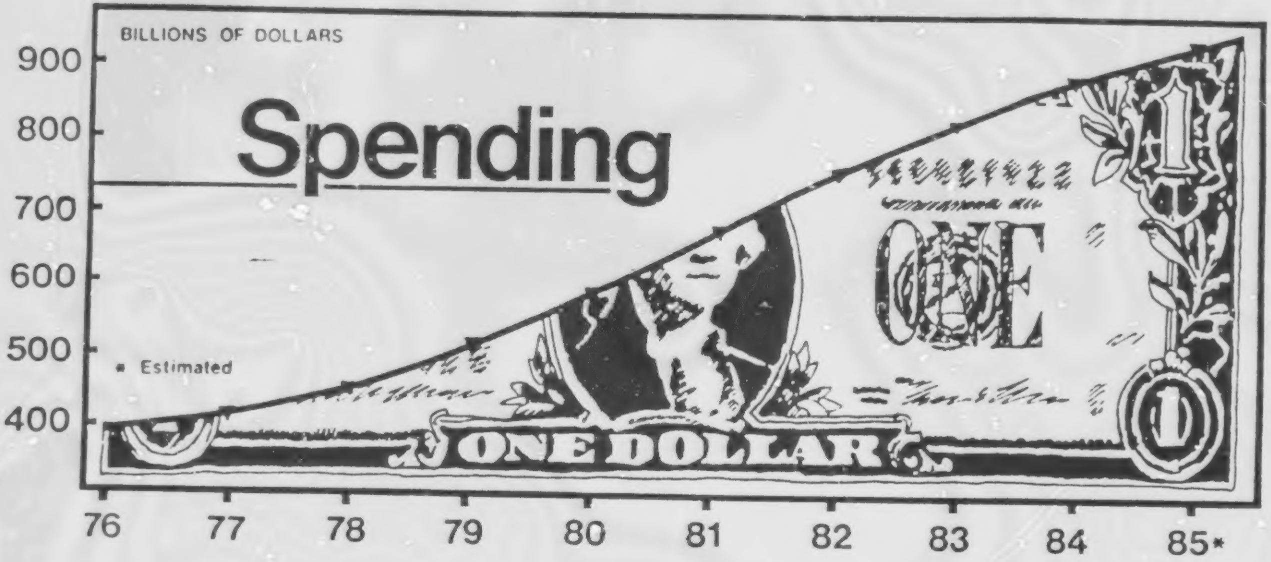
Those three charts on that wall show some technical comparisons between the three major tax proposals that we will hear about in Washington today; and if you compare it with the existing situation, this is the current tax system for an individual. It's actually shown as a—at the rates of a married couple with two children. These levels here are all meant to be consistent so that you can see at what level the different brackets become effective.

This is the revised plan the President proposed with the $2,000 per person exemption and then three brackets above zero—15, 25, and 35. And these are the other two major proposals, the Kemp-Kasten plan with two brackets and the Bradley-Gephardt plan with three brackets.

This chart shows the same impact on businesses. This is the present system and the maximum corporate tax rate. This is the small business tax rates. The Reagan plan has three steps—the 15, 18, and 25 percent, depending on the size of the business. And the Kemp-Kasten has the single rate of 30 percent for every business in the economy, corporations and unincorporated businesses; and so do Bradley and Gephardt.

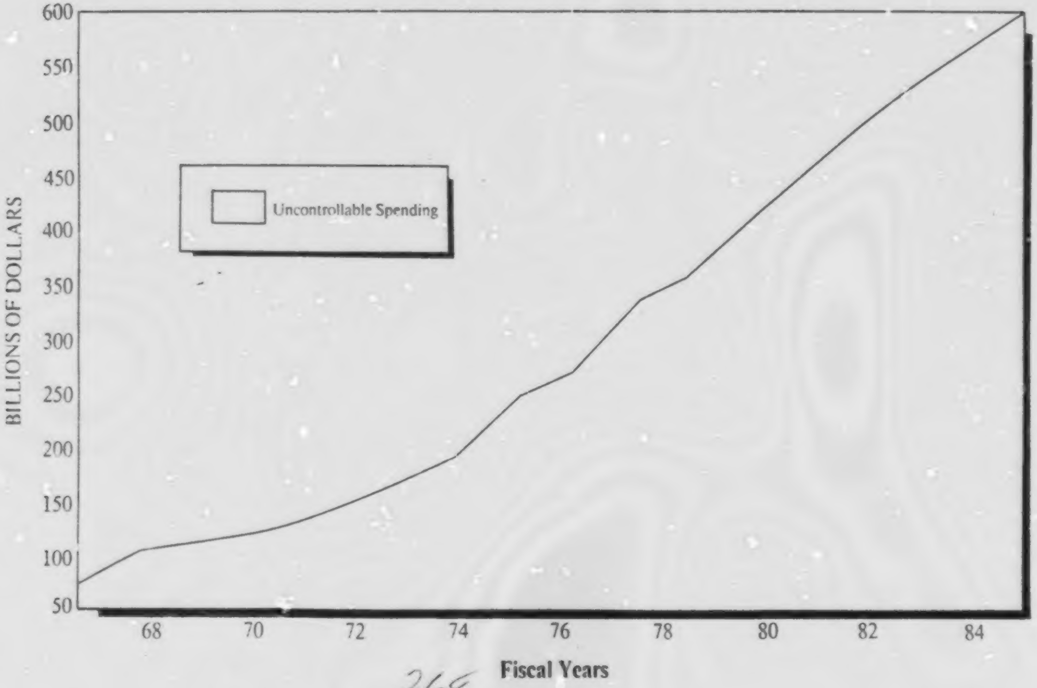
This chart here I want to explain in detail, but you can study it later during break. It shows the effect of the President's tax plan on different income sizes; and it shows how many people get tax cuts, how many people down here have to pay more, and how many people in the middle on the average would be unchanged.

[The charts referred to follow:]

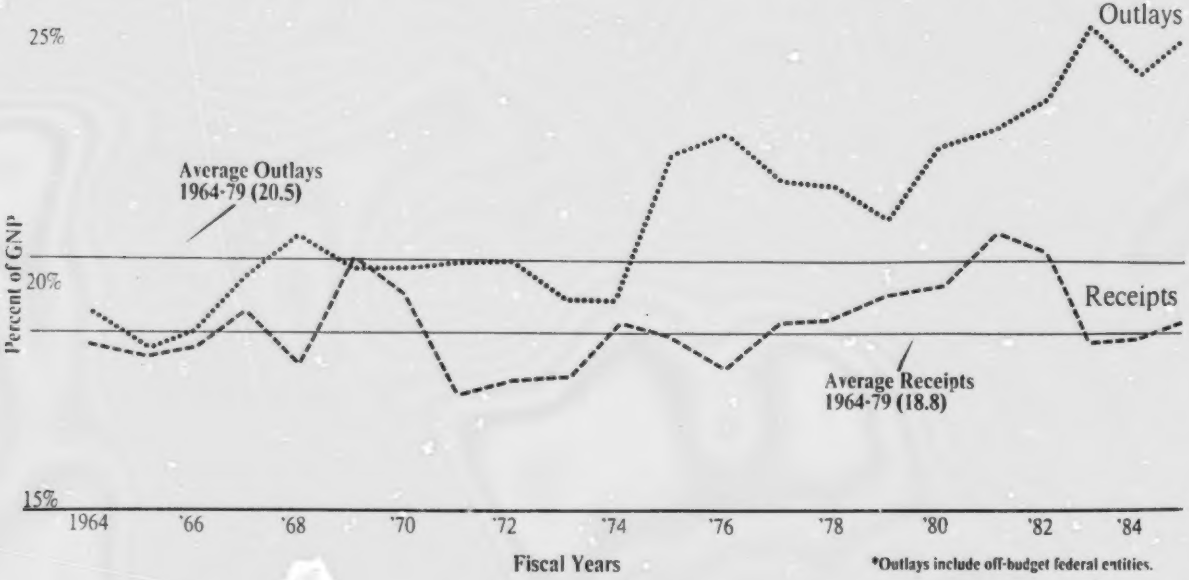

BILLIONS OF DOLLARS
Spending
900
800
700
600
500
400
* Estimated
ONE
ONE DOLLAR
1
76
77
78
79
80
81
82
83
84
85*

"Uncontrollable" Spending from 1967 to 1985

(Entitlement Programs, Price Supports, Interest on Debt)

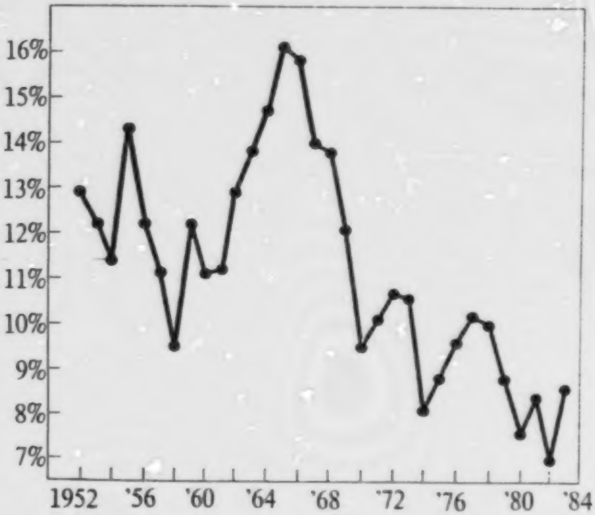


Outlays and Receipts
Percentage of GNP, 1964-1990



*Outlays include off-budget federal entities.

Long-Term Slide In Business Profitability*

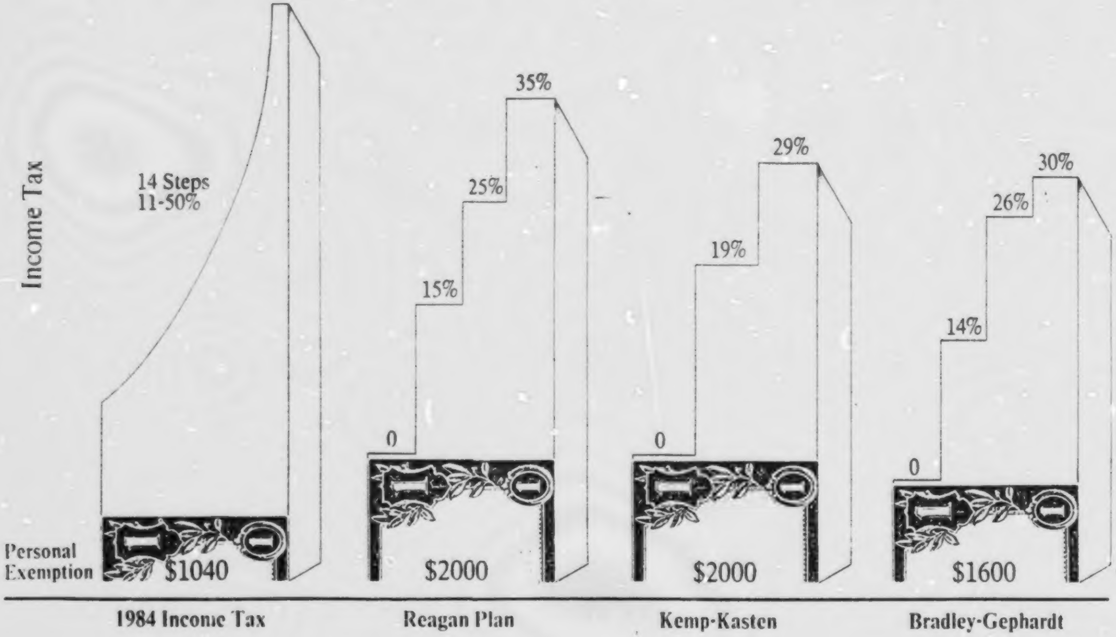


*Nonfinancial corporations. Pretax profits (with inventory valuation and capital consumption adjustments) plus net interest as a share of the net stock of reproducible fixed capital at replacement cost.

Chart /Senate Republican Conference

Tax Reform Proposals

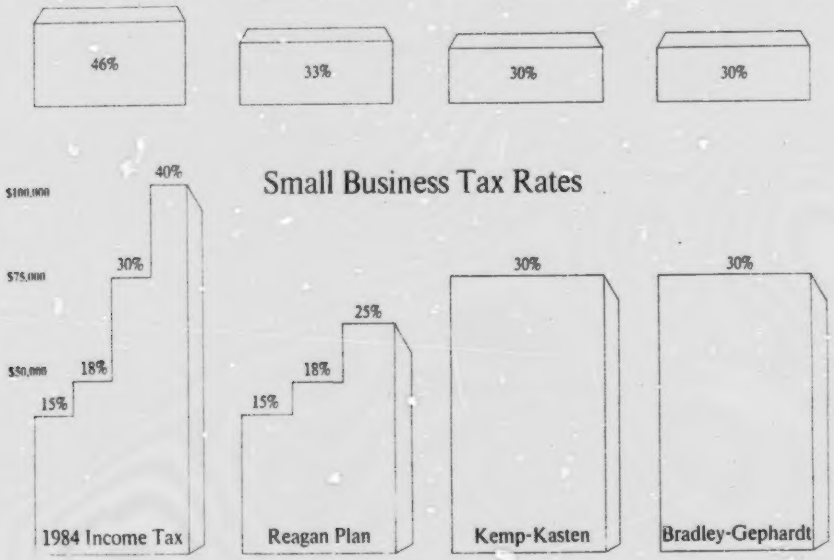
Married Couple With Two Children



Chart/Senate Republican Conference

Maximum Corporate Tax Rates

Small Business Tax Rates



Tax Change Percentage
by Family Economic Income (Under the President's proposal)

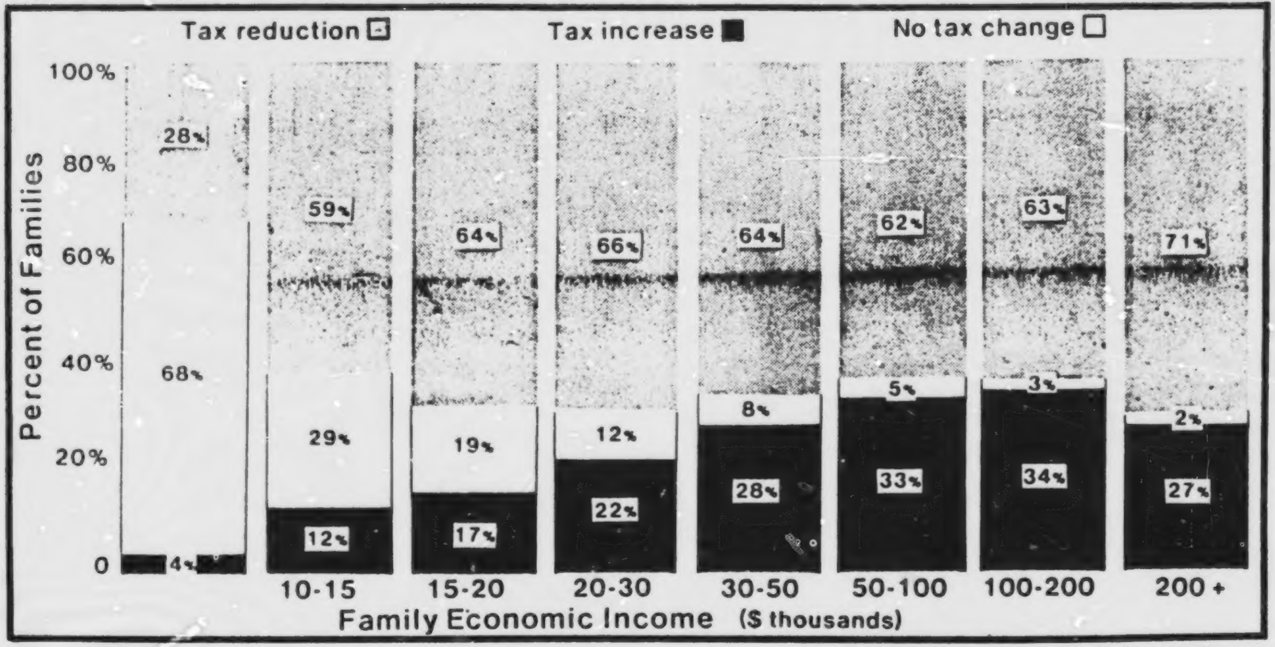


Chart /Senate Republican Conference

Senator **Symms**. Thank you very much, Joe. We're now ready to start with our first panel, which is an agriculture panel to discuss the various tax proposals and how it impacts farming. Would Mr. Dave Spencer; George Moir; Bruce Mitchell; Tom Loertscher; and Mark Jones—and, Tom, I may ask you a couple questions—come on up to the panel here. I may ask you a question or two about the tax deductibility of local and county taxes, too. I know you're not a county commissioner now, but you were.

So the first witness will be Dave Spencer. We're running just a little late.

Gordon Moir.

Mr. **Moir**. Yes.

Senator **Symms**. Oh, I'm sorry. Excuse me. I've got George on the list here.

Mr. **Moir**. And strike the E out of Moir.

Senator **Symms**. How do you pronounce it?

Mr. **Moir**. "Moir," M-o-i-r.

Senator **Symms**. Moir, OK. M-o-i-r, no E in there. Other than we missed your first and last name, everything was OK. The initials are right.

Mr. **Moir**. Yes, the initials are right.

Senator **Symms**. I'm sorry about that. Well, Dave, you go ahead. I apologize. I didn't get to eat breakfast this morning. I'm going to have a little farm cooking there from McDonald's.

STATEMENT OF DAVID SPENCER, FARMER

Mr. **Spencer**. I'd like, first of all, to thank Senator Symms and his staff for allowing us the opportunity to express our views and opinions concerning the tax proposal initiatives.

I'm presently farming. I kind of represent a little bit of dairy and a little bit of just farming. I do both, and I started approximately 10 years ago. When I started, everybody said I couldn't make it; and now it's getting to the point where I'm starting to believe that, too. That's why I come to this meeting, because I feel like the proposal would be quite hard on the farmers as the way the President has proposed it at the time.

I used kind of as a basis for some of my opinions and judgments the President's tax proposal to the Congress for fairness and growth and also a recent copy of the Farm Journal, which had an update on some of the new proposals concerning the tax law.

But first of all, I'd like to address the investment tax credit. The President's new law would drop investment tax credit, which is called ITC; and the administration's view on this is that by dropping investment credit, it will help get outside money out of agriculture, which everybody knows at this time agriculture is struggling because of overproduction. They feel like this outside money being poured into the economy is contributing to overproduction.

But the only problem with this type of thinking is that there is no distinction between the family farmer or the investor. Everybody gets treated the same. So all that would happen in reality is a family farmer would be left in the situation he is without the tax advantage where your investor would move to some other tax shelter, such as, municipal bonds for public purpose, which would remain tax exempt.

The new law also supports dumping accelerated cost recovery system known as ACRS. This ACRS method now allows farmers and small businesses, et cetera, to depreciate out a lot of their assets on a 5-year basis, which is more in step with reality. Most family farms cannot afford any machinery at all; and whenever they can, it is generally used. So if you put this used machinery on long-term tax depreciation tables, it just isn't economically sound or feasible.

The new law also supports replacing this ACRS method with a capital cost recovery system, which is called a CCRS. This method would slow depreciation rates down on machinery from anywhere of 7 to 8 years. It would be a straight line depreciation type method which—and then along with this, there would be—let's see—an inflationary indexing.

The inflationary indexing would have to be determined every year as to what the rate of inflation was. Therefore, the person willing to invest his money into his business or into farming would be taking a bigger risk not knowing what that inflationary rate was going to be every year. It kind of gives somebody more of a variable to work with. And by just accepting this at this time, I feel like you'd be signing a blank sheet of paper agreeing to let someone fill in the details later.

The results of dropping investment tax credit and changing the present depreciation method in favor of the CCRS would not only hurt farmers, but would hurt small businessmen, implement dealers, manufacturers, et cetera. And in light of recent happenings within the economy, I don't think we can afford this.

It was just recently that International was taken over by Tenneco because they couldn't afford to stay in business, couldn't sell their machinery. Allis-Chalmers has just been sold out to a German-owned competitor, and many other implement dealers are in financial trouble.

Also, many things that are mentioned in this proposal is that it's going to be simpler. They mention that by breaking it down in the three brackets—the current 15, 25—I mean changing it to 15, 25, and 30 percent makes it simpler. That isn't half of figuring taxes. Putting the percentage on it is quite simple.

I think, if you look through the tax tables, true there is a difference there; but if you look basically at the very bottom of the line, when you start out at $3,670 income to a $5,930 taxable income, the tax rate is 11 percent compared with the present proposal of $4,000 taxable income would go to a 15 percent. In other words, your tax rate is raised for those in the lower income brackets.

However, if you look at the other side of the coin, you take a person with a $175,230 taxable income, his tax rate presently would be 50 percent. Under the President's proposal, it would be dropped to 35 percent. Those in the high income appear to be getting somewhat of a tax break.

The new law would also raise self-employment tax for farmers. This would be accomplished by deducting—by eliminating some of the deductions now available as an operating expense for farmers. For example, soil and water conservation structures and land clearing would be eliminated. Fertilizer deduction would be capitalized and depreciated in lieu of the current method.

Income averaging would be dropped. Farming, being the risky business that it is, doesn't need income averaging dropped; and also these other benefits, if they were eliminated, would be very devastating to us.

According to the August issue of Farm Journal, the new law wouldn't allow you to deduct replacement——

Senator SYMMS. I don't want to interfere with your testimony, but I think one thing ought to be made in the record. How long do you consider ammonium sulfate put on the ground lasts?

Mr. SPENCER. I'd say 1 year.

Senator SYMMS. Do you think—ammonium nitrate wouldn't even be 1 year, would it?

Mr. SPENCER. No; one, you know, crop season. That's what, that's what I would feel.

Senator SYMMS. Go ahead. I just wanted to have that down. And do you other farmers agree with that?

Mr. MOIR. Absolutely.

Senator SYMMS. Is that your biggest expense in fertilizer is nitrogen?

Mr. SPENCER. And phosphate.

Mr. MOIR. Nitrogen and phosphate.

Senator SYMMS. OK.

Mr. SPENCER. OK. According to the August issue of Farm Journal, the new law wouldn't allow you to deduct replacement stock expenses as they occur. Instead, the owner must capitalize them and depreciate them in later years or deduct them when sold.

Concerning this change, I would like to read a quote from the Farm Journal by Lynn Stalbaum of the National Milk Producers Federation of Arlington, VA. Speaking of this method of depreciation, he says, and I quote, "It's going to be devastating to dairy producers because many of them raise their own replacements. Now they must carry the cost of raising all their replacements with no tax benefits until they are 19 months old. This proposal makes cars and trucks mileage accounting rule look like kindergarten."

May I ask the question, Is this simplicity?

In summary, it's my opinion that the present tax changes would make more hardships on farmers and small businesses. Those people who do not have money invested into their own businesses but with a high rate of income would benefit the most from these changes.

True, agriculture needs tax sheltered money out of it, but this is not the answer. There are simpler ways and means of accomplishing this. True, I am in favor of a simpler Tax Code and simpler tax rules, but I don't think the present tax reform, as it has been presented, is feasible in the farming industry. I thank you.

[The prepared statement of Mr. Spencer follows:]

PREPARED STATEMENT OF DAVID SPENCER

The following report was prepared by David Spencer and presented at a hearing held on August 13, 1985 by Senator Steve Symms. It is based on information obtained from the August 1985 issue of the Farm Journal and a summary of The President's Tax Proposals for Fairness, Growth, and Simplicity.

The President's new tax law will drop the Investment Tax Credit (ITC). The Administrations view is that by dumping ITC it will stop outside sources from tax sheltering money in agriculture. The problem is that there is no distinction between the farmer or the investor. Family farms will be adversely effected while the investor would merely be going to the other tax shelter left in the Reagan tax law, such as municipal bonds (public & purpose) which are tax exempt. (pg. 30 of the summary of the President's Tax Proposal)

The new law proposed supports dumping Accelerated Cost Recovery System (ACRS). The present law lets farmers use the ACRS method in which you are able to depreciate machinery over a five year period. It is more in step with the family farm needs. Due to low prices and cash flow problems family farmers have to turn to buying used machinery. If this machinery is put on long depreciation charts it is not in touch with reality. It isn't economically sound.

The new law supports replacing the ACRS method with Capital Cost Recovery System (CCRS). This method slows depreciation to a seven or eight year straight line method and also indexes depreciation with inflation. Every year someone must decide what this index will be, thus indexing could change from year to year leaving an unknown for the person willing to invest money in his or her business. Instating this into law is like signing a blank sheet of paper agreeing to let someone fill in details of the agreement later.

The results of dropping Investment Tax Credit and changing ACRS Depreciation in favor of the CCRS method would not only hurt the farmer, but implement dealers, manufacturers, ect.

The President claims the new system is simpler because it has three tax brackets (15%, 25%, 35%) instead of fifteen as presently used. Why is this part of it any simpler. There's a nickels worth of difference as far as simplicity is concerned. However under current law a taxable income of $3,670 - $5930 would be taxed 11%. Under the proposed new law $4,000 taxable income would be taxed 15%. (pg. 9 of President's Tax Proposal) Thus, the lower income people pay a higher rate. The current law would tax a person 50% on a $175,230 taxable income verse 35% on the President's proposal. (pg. 9 President's Tax Proposal) Those with a higher income get a tax break.

The new law would raise self employment tax for farmers by raising the base income. This would be accomplished by eliminating deductions now allowable. For example, soil and water conservation structures, and land clearing would be eliminated. Fertilizer deductions would be capitalized and depreciated in leiu of the current method. Income averaging would be dropped. Farming being the risky business it is, having good and bad years need income averaging.

According to the August issue of the Farm Journal the new law wouldn't allow you to deduct replacement stock expenses as they occur. Instead the owner must capitalize them and depreciated them in later years or deduct it when sold. Concerning this change I would like to read a quote from the Farm Journal by Lynn Stalbaum of the National Milk Producers Federation of Arlington, Va. Speaking of this method of depreciation he says "It's going to be devastating to dairy producers because many of them raise their own replacements. Now they must carry the costs of raising all their replacements with no tax benefits until they're 19 months old? This proposal makes cars and trucks mileage accounting rule look like kindergarten."

May is ask the questions, is this simplicity?

In summary it's my opinion that the new law proposed makes taxes more complicated for farmers. It will raise farm or business taxes while it lowers taxes for high income people who do not invest money into their own business. It helps those who need it least and hurts those who need it most. True, agriculture needs tax sheltered money out but these changes are not the answer. A simpler way would be to pass a law prohibiting outside money to be put into agriculture for a tax shelter.

Senator SYMMS. Thank you very much for a very excellent statement and a very helpful statement for our hearing record, Dave. We'll go on down the list and let everybody say something, and then I've got a few questions I want to ask. Gordon Moir.

STATEMENT OF GORDON MOIR, FARMER

Mr. MOIR. OK. Thank you. I'm Gordon Moir. I live south of Idaho Falls. My occupation is farming. I raise registered Angus breeding cattle and farm about 200 acres of land raising registered and certified seed grains, feed grains, alfalfa hay, and pasture. I'm a member of the Grange. I'm master of Bonneville County Pomona No. 18 and Idaho State Grange Overseer. The master of a grange is the same as a chairman or president of an organization, and the overseer is similar to the vice president.

I was asked to speak at this hearing to give my views and the views of the Grange. Thank you for allowing me to testify.

The Grange has traditionally always been nonpartisan. They have always tried to work within the system of government and work with whichever party is in office. The structure of the Grange is such that all policy is formulated from the subordinate or grassroots level. Since the tax reforms and particularly President Reagan's tax reform proposal was introduced earlier this year, the Grange has not determined its position and will not be able to do so until November at its national convention.

At the grassroots, resolutions are formulated. They are sent to the State offices; and at the time of the State convention, these resolutions are worked on and acted upon. Those with national scope then go with the delegates to the national convention, which I mentioned is in November; and then the policy will be formulated from that. There are several points that can be discussed that the Grange has already taken a position on.

There are proposed changes in the income tax system that will have a definite impact on the farmer. He uses the same tax-saving investments that the big-money investor uses to save tax dollars. So the proposed tax reform is going to have a definite impact on his operation that will cost him many tax dollars.

The proposed repeal of income averaging will hurt. The up and down prices of potatoes, livestock, grain, and nearly every commodity raised on the farm will force the farmer to pay more income tax when the income he receives from the high-price years cannot be offset by low-price years.

The proposed repeal of investment tax credit and proposed changes in allowances for depreciation will hurt. It has been one way the farmer could reduce his taxable dollars when prices were good. He could invest in machinery, equipment, and land; take the allowable tax credit and depreciation; and keep his farming operation up to date. When a new grain combine can cost $50,000 or more, just as an example, we are talking about major investments. This tax change would definitely have a very quick effect on the farming operation. Without the depreciation currently allowed, the farmer would lose the incentive to reinvest in his business.

The proposed changes in handling of capital gains will hurt, particularly the proposed repeal of capital gains on livestock. This would have a very quick effect on the cattle market. It will discourage the outside investor in cattle, but also force many long-time stockmen to sell out or reduce their cattle numbers. The number of female stock and total cattle numbers would lower probably causing an increase in cattle prices.

But I might explain here that, as Dave mentioned, it is very expensive to raise a replacement heifer. She's 2 years old before she produces a calf, and she's 3 years old before that calf goes to market when you have any return. In the meantime, you have all this expense that keeps going on. Other types of livestock vary, but they're all in a similar situation.

The proposed repeal of deductions for fertilizer, land and water conservation expenses, land clearing expenses would be very detrimental to the farmer. It is a very shortsighted proposal. Because of low cash flow, the farmer would be forced to decrease the amount of fertilizer he used on his land thus lowering yields. I suppose this is what the administration would like to see, but it seems to be the wrong way to go about it.

It has been predicted that the long-term effect of this tax reform will cause a lowering of land prices and discourage the nonfarm investor from buying land. They feel that the price of land will more nearly stabilize so that it can pay for itself, which it certainly cannot do now. It is a catch 22 situation because land has always been considered a good investment; and as soon as land prices lower, there will be investors of all kinds to buy it.

The National Grange has long supported the limiting of nonfarm income that can be sheltered by farm losses. Tax-loss farming by nonfarm investors should be discouraged. However, many farmers lease the land they farm. They do not have to invest money to put into farmland. Those that have bought enough land to make a living from are forced to use deficit financing to operate. By "deficit financing" I mean they have to mortgage the real property to finance the yearly operation.

It does not appear to me that the President's tax reform proposal will help the farmer. Even the higher personal deduction and lowering of tax rates do not appear to be able to offset the additional taxes that would accumulate from the proposed changes.

I feel we would be throwing the baby out with the bathwater if we adopt this simplified tax proposal. We are all geared to the present situation.

We would all like to see our own taxes lowered and see an increase in total tax revenue, but I don't feel we should change our present taxing structure just to simplify it. It would only result in higher taxes being paid by middle-income taxpayers, the ones who are bearing the brunt of the tax burden now.

Now, I suggest that we eliminate some of the tax shelters now being used, such as, real estate investments trusts; closely held corporations who take deductions for country club dues, entertainment, health insurance premiums that are being paid for shareholder employees.

The information that I have given here, part of it came from my accountant, part of it from a neighbor who is a retired IRS district director, and part of it from the National Grange, and part of it from U.S. News & World Report. Thank you.

Senator SYMMS. Thank you very much, Gordon. That was also an excellent statement. And I'm going to have some questions for both of you, but first I'd like to hear from Mr. Bruce Mitchell from Terreton. Where exactly is Terreton?

Mr. MITCHELL. Terreton is on the Mud Lake area. You've heard of Mud Lake I guess.

Senator SYMMS. OK. Right. I've been out there. I've been out to Terreton now that I think about it, as a matter of fact. Jack Gerrard is from out there. I think Jack may be here. Is Jack here in the room today?

A VOICE FROM AUDIENCE. Jack didn't make it. He was going to be here Thursday.

Senator SYMMS. Jack Gerrard has been following these hearings. He works for Senator McClure, and he's from down in your country.

Mr. MITCHELL. Jack Gerrard died 2 or 3 years ago.

Senator SYMMS. This would be one of his either son or grandson.

Mr. MITCHELL. Yes; that would be a grandson.

Senator SYMMS. Mr. Mitchell, we look forward to hearing from you.

STATEMENT OF BRUCE MITCHELL, FARMER

Mr. MITCHELL. Well, I was raised on a farm out there at Mud Lake, and I purchased the farm from my brother and dad a number of years ago. And I sold the 800-acre farm last year. So now all I have is 40 acres. So I'm not what you call much of a farmer.

But I think I can cover this best more or less by reading what I've written here.

Senator SYMMS. Usually that's the case. Most of the time when people try to summarize their statement to make it shorter, they end up drifting off into all other subjects; and it takes them 10 minutes instead of 5. But go ahead.

Mr. MITCHELL. My view of tax law is that of a retired aerospace engineer and a social security recipient and a small farmer. We all have many different types of taxes to pay—sales, property, gasoline, and income tax to name a few. The income tax is only a small portion of the total tax paid by people with low income.

The farmer has a lot of money tied up in expensive machinery that sits idle most of the year. This machinery is taxed along with his farm even though the bank has the major claim on everything he owns. In addition to the bookkeeping necessary for his income tax, he must account for Social Security and withholding for any employee that he hires. Even though he needs help for only a short time, he must report the withholding tax every 3 months. The burden of too much government is felt the year round.

I'd like to remark that when I was raised on the farm out there, there wasn't any government interference of any kind; and we got along fine.

Our ability to pay taxes depends upon our income. To be fair to all, the tax should be a flat tax on income only with no other taxes added on. The existing income tax has become very complex for anyone with income other than wages, so any change must be better. The President's proposal does broaden the tax base and is of some help to people like myself because it will cut a little out of the income tax that I now pay. Increasing the personal exemption to $2,000 helps most. Reducing the number of tax brackets also helps; and in my own case, the reduction in the capital gains tax will help a little.

The President's proposal is better than the existing tax, but it is still too complex. I would rather pay a much higher tax if it could be changed to a simple flat tax on income alone. I would like to see it applied to last year's income to be paid this year. In that way I could know a year in advance how much my tax would be and plan accordingly.

There is a way to get a single flat tax that is fair to all at all income levels—cut out all special deductions, such as, depreciation, gifts, and charity; and report all income from all sources; then allow an income or tax credit of exactly the same amount to every citizen. That credit would be added to the income of each one and the same flat rate applied to the total to determine the tax for the individual. This is shown by a simple equation and examples attached.

The equation is to take the total, the total amount of income over the Nation and add that to the budget—I put that down wrong. It should be—and I've got to make a correction on that. The total—that should be a C there instead of a B in that equation.

Senator SYMMS. Where it says A plus B?

Mr. MITCHELL. A plus C.

Senator SYMMS. Or A plus C.

Mr. MITCHELL. Times R equal B plus C. Where A is the total personal income of all citizens, B is the total government budget, and C is the total sum of all credits allowed. R is the tax rate.

Now, taking an example, I assumed that the total income would be about $4 trillion. That's somewhere near what it would be, but I don't know what it would be if you got all income in there. And I assume that the budget would be $1 trillion. That would make simple numbers to work with here. The population is about 240 million.

So if we took a credit of $1,000, $2,000, or $3,000 to each individual, then the tax rate would figure out to be 29.2 percent if $1,000 credit was given or 33 percent if $2,000 credit were given or 36.4 percent if $3,000 credit was given.

Now, anyone earning no income at all would receive $1,000, $2,000, or "$3" from the Government back. But anyone with $10,000 income would pay an actual tax rate of 22 percent if he had a credit of $1,000 or 17.3 percent if he had a credit of $3,000. If he was in the $50,000 bracket, he would pay a tax rate of 27.8 percent or a tax rate of 32.6 percent on a $3,000 credit.

Now, with this kind of a national tax system where the income and tax could be reported and paid by family groups with no change in the total tax paid—so it could be simplified a great deal. Now, there are variations that could be made, but this is one way I think that you could arrive at a single simple tax.

[The equation attached to Mr. Mitchell's statement follows:]

$$(A + C)R = B + C$$

Where:

"A" is the total personal income of all citizens.
"B" is the total government budget
"C" is the total sum of all credits allowed
"R" is the tax rate.

I do not know what the total income would be under these conditions but believe it would be about $4,000 billion. The federal budget is now about $1,000 billion. The population is now nearly 240 million. Let C and R be variables. Take three examples. Allow an income credit of $1,000; $2,000 or $3,000 and solve for R.

billions				credit $	$ tax to be paid	actual tax rate	income level
A	B	C	R				
4,000	1,000	.240	.292	1,000	-1,000	0	0
		.480	.330	2,000	-2,000	0	
		.720	.364	3,000	-3,000	0	
		.240	.292	1,000	2,212	.221	$10,000
		.480	.330	2,000	1,960	.196	
		.720	.364	3,000	1,732	.173	
		.240	.292	1,000	6,592	.264	25,000
		.480	.330	2,000	6,182	.247	
		.720	.364	3,000	7,192	.288	
		.240	.292	1,000	13,892	.278	50,000
		.480	.330	2,000	15,160	.303	
		.720	.364	3,000	16,292	.326	
		.240	.292	1,000	28,492	.285	100,000
		.480	.330	2,000	32,660	.327	
		.720	.364	3,000	34,492	.345	
		.240	.292	1,000	291,292	.291	1,000,000
		.480	.330	2,000	328,660	.329	
		.720	.364	3,000	362,092	.362	

With a flat tax system like this, income and tax could be reported and paid by family groups with no change in the total tax paid.

Senator **Symms**. Well, I thank you very much. That's kind of interesting. Have you heard of the Hall-Rabushka flat tax plan that was written by the Hoover Institute and these two economists?

Mr. **Mitchell**. Yes, yes.

Senator **Symms**. You're similar in the idea of what they're trying to do.

Mr. **Mitchell**. And I like that quite well.

Senator **Symms**. Senator DeConcini and I have introduced that in Congress so it would be there for the discussion of this whole program. And the more I look at all these programs, the better I like it because it's simpler and you can understand it. And then you have a—you remove the bias from savings.

In other words, what you're saying is you wouldn't give anybody a deduction for anything, just pay taxes on their income?

Mr. **Mitchell**. Everybody would pay the same tax, but you would have a credit that——

Senator **Symms**. I wouldn't think your rate would have to be as high as you've got it.

Mr. **Mitchell**. Well, that's because I used the $4 trillion and a 1,000—or $1 trillion as the budget.

Senator **Symms**. Right.

Mr. **Mitchell**. If no one got any credit, then the flat rate would be 25 percent on the numbers that I have used.

Senator **Symms**. OK. Well, thank you very much. Next, Tom Loertscher.

STATEMENT OF THOMAS F. LOERTSCHER, FARMER

Mr. **Loertscher**. Thank you, Senator Symms, for the opportunity to testify concerning this important matter. Have you got a copy of this?

Senator **Symms**. I don't have a copy of it here.

Mr. **Loertscher**. I gave her the copy. She was going to run some.

Senator **Symms**. Dixie, do you have any copies of Tom's statement?

Ms. **Richardson**. I'll get them.

Senator **Symms**. OK. Go ahead. I'll listen carefully, and I'll read it when we get it here

Mr. **Loertscher**. I hope that what I have to say will be helpful to you in your consideration of tax reform. This is a very broad topic, and I must admit that I have not studied the proposal in depth in all areas. Where I do feel that I can be of some help is in the agricultural area. I will be speaking from two points of view. The first is that of a farmer, one who is trying to make his living from farming, not merely an investor or as a tax shelterer. Second, I will view it from the accounting perspective, both recordkeeping and income tax preparation.

As stated on the cover of the President's proposal, the goal of this tax reform—this tax-reform package—is to promote fairness and growth and bring simplicity to the system. There can be no argument that these things are all needed. If my understanding of the parts of the proposal that affect agriculture are correct, simplification will not be achieved, but rather tax accounting for the farmer will be complicated.

Some of the specifics of my comments on them follow:

Dropping the 10 percent investment tax credit or the ITC. This is clearly a tax break, but it does have some value in tough times for farmers. In good times when profits in agriculture are up, which is rare indeed, taxes can be avoided with the ITC. What some farmers do not understand, however, is that when ITC equipment is disposed of, there are grave tax consequences. Under the right circumstances, the ITC must be partially or completely paid back. In tough times when farmers need new equipment, the cost has been effectively reduced by the use of safe-harbor leasing. Looking at the ITC with an open mind, however, its elimination will simplify the farmers' tax accounting and my—and from my perspective, will not do him much harm overall.

Dumping the accelerated cost recovery system in favor of a capital cost recovery system. Depreciation of equipment is a matter that is dear to the heart of not only every farmer, but every businessman who owns equipment. The ACRS system which has been developed over the past few years has been a nightmare for every farmer. The old system of using a straight line depreciation method was much simpler, much easier to use.

ACRS provided only decisions to make at tax time that very few farmers were able to understand. While I do not understand the ramifications of the proposed CCRS plan, one thing I do know is that depreciation schedules will be further complicated by indexing for inflation. If simplicity is to be achieved in depreciation schedules, let us go back to pre-ACRS days, but allow only straight line methods to be used.

Replacing the 15 tax brackets with 3 brackets. The effects of this can only be positive.

Raising many farmers' self-employment taxes. I am not sure whether the proposal raises self-employment taxes directly or if they raise as a result of base incomes rising. During the current agricultural financial crunch, an increase in self-employment taxes would be devastating to many farmers.

Eliminating deductions for soil and water conservation structures as well as land-clearing costs. Soil and water conservation have been the topics of heated discussions nationwide. Soil and water are the two biggest and most important farm inputs. Their conservation is essential. If the deduction for these expenses is not allowed, practices may cease. If farmers do not have this incentive, they will not be in a position to do any conservation projects at all, even if they desire to do so. If no deduction is allowed for soil and water conservation, there will be a penalty imposed by having to pay taxes for the privilege of having to do soil and water conservation.

It can be successfully argued that land-clearing expense deduction and elimination will slow down new land development. It is my feeling that this would not be of grave concern to many farmers.

Doing away with fertilizer deductions, rather capitalizing and depreciating them. This part of the proposal has got to be a bad joke. Fertilizer is clearly an expense item. And you asked how long it lasts. If you're in the habit of using anhydrous ammonia, some of that fertilizer never gets to the ground.

Senator **Symms**. Spray it on?

Mr. **Loertscher**. Well, you shank it in usually; and by the time you're off the field, some of that fertilizer value is gone. So you've already—how on Earth do you capitalize something that you've lost initially? It normally lasts 1 year or for one production season.

From an accounting standpoint, what possible basis could there be used to depreciate fertilizer which will be used up before you get to the next accounting year? If the goal here is to eliminate the possibility for a farmer to buy fertilizer at the end of the year to defer taxes by prepayment, there is a simpler way to get at this. Requiring farmers to go to the accrual system where expenses must be matched with cost of production is a much simpler way to eliminate the prepayment provisions as they now are.

Senator **Symms**. Say that again. You say it would be——

Mr. **Loertscher**. Prepayment of fertilizer expenses and feed expenses has been the catchall for the cash basis taxpayer if you go where he can avoid taxes one year by shifting the cost of those items into a year where his income is high.

If you eliminate—if you go on the accrual—you understand what I'm saying?

Mr. **Ripley**. Oh, sure.

Mr. **Loertscher**. If you go on the accrual basis, then your production is offset against the cost during the year you're doing it.

Mr. **Ripley**. That certainly wouldn't simplify it, though.

Mr. **Loertscher**. Well, it certainly is simple to me. As far as—it's more difficult for me to try to guess at the end of the year whether I've got to buy something else or if I can sell anything than it is to just say "OK. I produced this. That's income during this year and all the expenses that are taken against that."

So in my view, that's simpler than for the farmer to sit down, "OK. What have I got to sell this year to avoid taxes, or what"——

Senator **Symms**. Or buy.

Mr. **Loertscher** [continuing]. "Can I sell? What have I got to do?"

Senator **Symms**. Are you on an accrual system?

Mr. **Loertscher**. Yes; I use the accrual——

Senator **Symms**. I think you and I talked about that once. You told me that you're on an accrual accounting method. Most farmers that I have come across are all on a cash accounting basis.

Mr. **Loertscher**. But even my system isn't true accrual because there are certain expenses that ought to be shifted into the next tax year that you don't, that you don't do.

But by following the rules as they are now, I've found that it's simpler. I don't have to worry about what's income this year and what's going to be income next year. If I raised it this year, it's income this year; and it's put in inventory regardless of whether I sell it. So it's much simpler in my view to do it that way.

Senator **Symms**. What do you do if the price goes down on the product you're keeping?

Mr. **Loertscher**. It's reflected in next year's taxes in the sales.

Mr. **Ripley**. What price do you put it into inventory?

Mr. **Loertscher**. At the market price that's reflected at the end of the tax year.

Senator **Symms**. So if you're talking about storing wheat or something, you——

Mr. **Loertscher**. Or your cattle herds, as you carry over your inventory of cattle, those steers and things that you're going to be selling into the feeder market, they're income the year they're born. And then as you sell them, then that adjusts, you know, your income in the following years.

It's much simpler, I think, from—maybe I'm confused, but it's much simpler for me at least to handle it that way than to have to say, when I don't have time at the end of the year, say "Gosh, can I sell this? Have I got to sell 100 head of cattle this year? Have I got to sell 10,000 bushels of grain?" And then put all that extra stress on you at a time when you don't need it.

Senator **Symms**. Well, I'm interested in having your testimony because, see, I grew up in a family farm; and we always did it just opposite. And we sat down and tried to figure everything out and defer income by buying fertilizer, spraying materials, cartons, baskets, whatever. It would be next year's. So we were always investing in next year's expenses. Tends to keep farmers out of trouble.

Mr. **Loertscher**. But I think if the goal here—and I don't know what the President's goal here is; but if it's to eliminate that, then it can be covered by the accrual system.

Senator **Symms**. In my opinion, your statement here is right on target when you said this must be a bad joke. What's this—about to depreciate the cost of fertilizer or to—where was that? You had that. You said, "This must be a bad joke."

I couldn't help but think—see, I don't think the President has any idea that anybody down at the Treasury Department—it's some bureaucrat down in the bowels of the Treasury that wrote that that's probably never seen a farm, doesn't understand it, and thinks that—you know, maybe he's been raised in Kentucky or something where I think that they do sometimes go in and lime soil or, you know, in the Midwest farms where they'll put on a heavy application of lime that is—that does last longer. You know, I think you might make a case on that.

But the kind of fertilizer we apply out here, like I say, if you're sprinkling on nitrogen on potatoes, it's used up on that application.

Mr. **Loertscher**. The first few days.

Senator **Symms**. Right. I mean you put a little bit in all the time.

Mr. **Loertscher**. Some forms of sulfur do last for up to 5 years that you can put on the land, but they're not effective in the current year. So most of the forms of sulfur that people are putting on, that farmers are putting on, are the type that can go to work now rather than——

Senator **Symms**. There's some kind of spray that we put on soft fruit trees, spray on the fertilizer, spray it right on the tree. It's instantaneous. I mean the tree uses what it's going to get out of it in 2 or 3 days, and there's no way you could ever justify trying to make somebody account for that any way other than as an expense.

Mr. **Loertscher**. I'm assuming and giving them the benefit of the doubt and not being too critical, I guess, that they're seeing very large fertilizer expenditures, and they're saying "Hey, gosh, if a farmer is spending $20,000 or $30,000 a year on fertilizer, that's got to be a capital expenditure."

So if you give them the benefit of the doubt, they're saying by the sheer size of the fertilizer deduction as we know it—you know, they're not looking at it from what it's used for or how it is, but rather by the size of the expenditure. Making it more difficult to defer estate——

Senator SYMMS. My accountant here says that he'll start giving the IRS a benefit of the doubt when they start giving us the benefit of the doubt.

Mr. LOERTSCHER. Not a bad plan. Making it more difficult to defer estate and trust taxes. I am by no means an expert in estate planning. It is difficult for me to comment on this part of the proposal except that the more difficult it is for one generation of farmers to pass their assets to the next, the fewer family farmers there will be in the future.

Dropping income averaging. Income averaging has been in some people's minds very complicated. In my view, income averaging has been a tool merely to even out taxes over periods of time when income fluctuates a great deal. Its effects have largely been positive but have not created any huge tax savings in the long run. In other words, income averaging does not save taxes. It merely spreads it over a period of years.

And that statement isn't entirely correct; but in my view, that's what income averaging does. And its elimination, especially if you're on the accrual system, really doesn't help you that much. It doesn't delay those taxes substantially.

Eliminating capital gains treatment for breeding stock sales. For those who merely inventory cattle, such as the feeders, there is no effect of this proposal. However, for those people who engage in cow-calf operations, this is devastating. What it will do will cause a tremendous tax increase for one segment of the cattle industry. There is very little or no incentive at the current time for people to be in the cattle business. Profitability is at an alltime low. Removal of capital gains treatment for breeding stock will be a further knife in the heart of the cattle industry.

Deduction for expenses of home-grown replacements. Senator, you and I talked several weeks ago about the concerns of farmers regarding the accrual system. I don't know if this is what you were referring to or not. If it was, I share the concern of those farmers as well. This policy would so complicate the accounting for replacements in a cattle herd, a rancher or dairyman would throw his hands in the air and not know how to cope with such a vast accounting problem. To quote Mr. Lynn Stalbaum, again, with the National Milk Producers Federation of Arlington, VA, quote, "This proposal makes the cars and trucks mileage accounting rule look like kindergarten," unquote. There is no way that this proposal can be beneficial to anyone except tax accountants.

I appreciate the opportunity to testify here today and will be willing to provide any other information which might be helpful.

Senator SYMMS. Thank you very much. That's a very informative statement also. Mr. Mark Jones.

STATEMENT OF MARK JONES, DAIRY FARMER

Mr. JONES. OK. I apologize for not having a prepared statement. I got busy with other things and didn't get it finished.

Senator SYMMS. That's OK.

Mr. JONES. Primarily there are several things that have already been mentioned that concern me. One is this business with the replacement heifers. The more I think about that, the only way I can see that a fellow could do it would be to keep an individual financial record on——

Senator SYMMS. Are you a cattleman?

Mr. JONES. I'm in dairy.

Senator SYMMS. OK. So when you grow—if you're a cow-calf operator, you grow a calf into a mature cow then and sell it later. You get capital gains treatment; is that correct?

Mr. RIPLEY. On the breeding stock.

Senator SYMMS. On the breeding stock.

Mr. JONES. Uh-huh.

Senator SYMMS. If you keep that cow and have several calves you mean?

Mr. RIPLEY. He's the dairy farmer—right, Mark?

Mr. JONES. Right.

Mr. RIPLEY. So he's talking about his milking cows.

Mr. JONES. Primarily I'm concerned about the thoughts of—the effect that this has in raising those replacements.

Senator SYMMS. In other words, you can't expense it off?

Mr. JONES. Yes; in other words, you've got to carry the expense of raising a replacement heifer for basically 2 years before you can write off a nickel on what she's cost you and due primarily to the fact that on dairying you're stringing these heifers out over an entire year.

The only way I could see that a person could do it would be to keep an individual financial record on each one of those calves until she becomes productive, and then you could start depreciating off the costs that you had. And it looks to me just like a great big nightmare.

Senator SYMMS. Well, this means you've got to come up with more money.

Mr. JONES. Not only the accounting nightmare, but there's money there that I won't have for other investments.

Senator SYMMS. I mean for the first 19 months that this thing will be put into effect, it would really squeeze the cash flow of all dairy people.

Mr. JONES. Dairymen and cattlemen as well. It's going to do the same thing to them. And consider that on many dairy operations, close to half of the animals on that farm are at some stage of growing rather than being in the production string, it's looking at a tremendous amount of cash that's going to have to be used to support these animals that you won't be able to deduct in any way.

Senator SYMMS. How would this affect the guy that comes in with a syndicated group of investors and buys 500 springers and starts a dairy? Would that tend to keep them out?

Mr. JONES. Actually——

Senator Symms. I'm trying to figure out where anybody came up with a harebrained idea like this. So explain it to me.

Mr. Jones. Actually this is the only group that I can see that could possibly work under these conditions. They'd be able to afford the battery of accountants and tax lawyers to work around all of this. The rest of us, it would just be a tremendous load on that we wouldn't——

Senator Symms. How long of a depreciation schedule could you put a milk cow on? Could somebody help me on that? How long do you milk one of these cows? Five years?

Mr. Jones. Well, you can figure—I guess you figure 5 to 7 or something like that, but on an average you get approximately three lactations overall when you take in the Nation's dairy herd. And so she's only producing about 3 years in actuality.

But so the workability of this thing is what concerns me more than anything else. It looks to me like we would be much better to set some basic guidelines and then have the accounting procedures—do that between the farmer and his accountant.

Senator Symms. Well now, if we maintained the current tax law—I didn't mean to cut you off. Have you made your point.

Mr. Jones. Go ahead.

Senator Symms. If we maintain the current tax law for farming and gave up the investment tax credit, where would that put you? You said it wouldn't be that important, didn't you, Tom. Or was it Gordon. See, the reason I——

Mr. Loertscher. My farming operation hasn't been profitable enough to use any investment tax credit——

Senator Symms. You haven't made any profits to have the ITC make any difference anyway.

Mr. Loertscher. In the long run, if you dispose of an asset, you still have to recapture—I mean you have to—not recapture it. You have to pay it back.

Mr. Ripley. Well, not if you keep it the length of time.

Mr. Loertscher. If you keep it the right length of time. But, you know, that doesn't always happen. A farmer has got a lemon piece of equipment he's got to get rid of, and he gets to pay for the privilege of getting rid of it under ITC.

Senator Symms. How many people here in this area have built either new dairies or potato warehouses that you're aware of that are—would be hit by this recapture clause that's in this bill? Nobody mentioned that. But maybe the farmers haven't had that—wouldn't affect that many of them. There's a lot of businesses that have built buildings——

Mr. Loertscher. What's the provision that's in the bill?

Senator Symms. I'll let Rip explain it.

Mr. Ripley. I doubt whether it would have too much application. I guess you're talking about the recapture.

Senator Symms. Yes. Let's say some guy built a new potato packer. Now, I know there's one up here by—well, I guess that's over at St. Anthony, Rexburg.

Mr. Ripley. Well, first thing, he has to incorporate. It only applies to corporations.

Mr. Loertscher. Subchapter S as well?

Mr. **Ripley**. I don't think so. The purpose of that was—what their thinking was is where you're taking accelerated—or ACRS depreciation, that when they lower the tax rates from 46 percent to 33 percent on the corporations and you're getting this fast writeoff, they somehow have come to the conclusions that gives you a windfall. And so there would be a recapture tax on that, but I don't think it applies to individuals.

Senator **Symms**. ITC affect you, Mark.

Mr. **Jones**. At the present time it wouldn't affect me a great deal.

Senator **Symms**. Does it affect you, Tom.

Mr. **Loertscher**. [Indicates.]

Senator **Symms**. What do you think about that, Bruce? You already said you'd like to get rid of all deductions and have a lower rate.

Mr. **Mitchell**. [Indicates.]

Senator **Symms**. What do you think, Gordon?

Mr. **Moir**. Not in my present situation.

Senator **Symms**. Dave?

Mr. **Spencer**. I'm affected somewhat. And so I think overall it has a positive effect myself.

Senator **Symms**. To do away with ITC?

Mr. **Spencer**. To keep it.

Senator **Symms**. Oh, to keep ITC. So you would say to keep ITC. OK. Next question, would you prefer for me as a Senator on the Finance Committee to go back there and tell them to drop this whole subject until they get the budget under control, or would you rather keep pressing forward on tax reform?

Mr. **Spencer**. I'd prefer to see the budget brought under control myself first.

Mr. **Moir**. Absolutely.

Senator **Symms**. Gordon.

Mr. **Moir**. Absolutely.

Senator **Symms**. Bruce.

Mr. **Mitchell**. The same. I think the budget should be brought under control.

Senator **Symms**. Tom.

Mr. **Loertscher**. Absolutely. That's a priority.

Senator **Symms**. Mark.

Mr. **Jones**. If there's a choice, I'd rather see that budget balanced than anything.

Senator **Symms**. Well, see, you've said the same thing that the miners and the lumberjacks and the business people have said all over Idaho. That's what they're all saying. And some of us have been trying to tell the President that, but he's pretty determined that he's going to bring this up.

And I don't fault the President for his goal. What I fault is the details of the legislation. I would bet you a steak dinner that Ronald Reagan hasn't got any more idea that somebody in Treasury put this thing in here about farming than the man in the moon. I mean it's a 575-page bill.

But I don't understand how the people at Treasury could get away with writing this in a bill. It's just an absolute outrage for anybody that understands anything about agriculture.

Mr. **Jones**. That's why we're here is to let them know we don't want that in there.

Senator **Symms**. See, I have said that the part about lowering the tax rates—I told Chairman Packwood, "You can count on me. I'll vote for them to lower the tax rate, but from there on I'm not committing myself to anything in this bill." I mean there's a lot of things in this bill that are good. Lowering the tax rates and a few things are fine. But a lot of this kind of complication is not.

Now, Tom, I want to ask you a question, and you put on your old county commissioner hat. In the State of—there's one big part of this bill—the reason I'm asking these specific questions of the investment tax credit and in this question—there's one part of this bill that removes the right of citizens to deduct State and local taxes as an income tax deduction from their Federal income tax.

Now, Idaho is a State that that would be taking $65 per capita away from citizens of Idaho per year. And in New York State it would be taking $233 per year away from each taxpayer. If you live in New York City and are a high-income person, which their per capita income is very high in New York City—but their taxes are very high. They get to a point where they pay as high as 18 percent income taxes in New York City when they add the State and the city and the county and so forth in.

But any taxpayer that's in that bracket is in the 50-percent bracket on the Federal tax return. Therefore, it reduces that taxpayer's local taxes to 9 percent because he gets the deduction off his Federal tax return.

The question I'm asking is do you think if we had to give up some deduction, that that would be one that we could do without, you know. And you're a county commissioner, or you've had the experience in the county. How would you feel about that one?

We're way down the list in Idaho of what we gain and lose. The top 76 million people live in 9 States—New York, Maryland, New Jersey, Delaware, California, Massachusetts, Minnesota, Michigan, and Wisconsin. And they would—that's 34 percent of the population, and they'd get 50 percent—they would get—how is that, Rip? I should say that's 50 percent of the deductions in those nine States.

And those are all States that have prolific State budgets and State politicians that spend money for everything. They're got firemen retired, you know, that make more money than the farmers in Idaho—of course, they wouldn't have to make a lot—that are retired after 15, 20 years on the force.

And, you know, there's all kinds—now, they've corrected a lot of that stuff in New York City, but that's how it came about that there wasn't any effort to slow down spending in the city because these guys that are paying taxes say "Well, I can get a deduction on my Federal income taxes anyway." They don't worry about it.

But if you've got any comments, I'd appreciate it.

Mr. **Loertscher**. I am presuming that you're speaking of the deduction off a personal income tax return versus a business expense?

Senator **Symms**. Well, yes, right. What I'm saying is—let's just put this down here that it's Christmas Eve; and they've got the tax bill up there; and despite what I might think whether we ought to be doing this or the budget, that this thing is moving through the Congress; and you come down to where you're trying to keep some deductions in the bill to protect basic jobs in Idaho in agriculture, in timber and mining, and the resource producers.

But on the other side of it, it's $37 billion of revenue that taking away the deduction for State and local taxes raises for the overall tax bill, which then is turned around, and they're giving it back to people by reducing their tax rate.

So what I'm saying is if I was in a position where maybe I have to make a choice—it isn't the choice I'd like to make, but the choice is which deductions do I vote to give up and which ones do I vote that we won't give up. Would you say that State and local tax deduction would be less important than, say, capital gains treatment?

Any of you that want to comment on it, please speak up. Dave, you're nodding your head.

Mr. Spencer. Well, from my own personal point of view, I'd have to agree. This would be—you know, if you have to make a decision between either or, this might be one that could be done away with and negotiated out to get the end result.

Senator Symms. You thought about that, Gordon? Maybe you hadn't thought about it.

Mr. Moir. Hadn't thought about it before. I guess I'll have to agree with Dave there.

Senator Symms. I'm not sure that that deduction would cost anybody in Idaho their job. It might cost us an average of $65 per capita.

Mr. Moir. Sixty-five dollars per capita.

Senator Symms. I'm afraid that if some of these tax preferences are lost, that there's going to be families in Idaho that will find themselves out of work. So I mean some of those things I feel like that we have to talk about it for 6 weeks or 6 years in the committee until we get our way or the economy changes.

I mean you can't—these people are producing lead, zinc, and silver right now barely at the cost of production; and if you impose a new tax on them by taking away the depletion allowance, they're out of business. I mean they just have to stop. Well, then you've got thousands of people that are unemployed. I think that's critical.

This farming stuff is—I don't see how that's going to raise any money for the Treasury. So if it doesn't raise any money, we ought to be able to get it taken out of the bill and go back to the old way. Although, are there any of you or are there any farm operations here that—cattle feeding operations in the area that would be impacted by going to an accrual accounting system? See, Tom, you are.

Mr. Loertscher. I don't think the feeders will be impacted, but the cow-calf operation——

Senator Symms. I just think accrual accounting for agriculture, personally—my personal bias is that it's just absolutely crazy to make farmers do it. If you want to do it, that's OK with me. You've elected to do it. You've chosen to do it. I personally wouldn't want to make farmers do it.

And I'm concerned—asked my counselor here what the law says, but it says $5 million. Well, most family farms in Idaho don't have a $5 million income.

But it also says if they use an accrual accounting system to acquire credit—well, every farmer does that. If you go into the bank, even though you're on a cash basis, to try to get a loan, you're going to tell the banker "Well, I've got 10,000 bushels of wheat out here, and it's worth, you know, $3, $4 a bushel." You hope.

Mr. Moir. We usually fib to him a little bit about it's worth more than it is.

Senator Symms. Right. See, so you're using an accrual accounting to get a line of credit established then. So I could see how the IRS, being the way they are, they might come in and apply that and say "Well, you've got that on your financial statement at the bank. So, therefore, you've got to be on an accrual accounting." And that bothers me.

Do you want to make a comment, Mark? Pull that mike over there if you don't mind.

Mr. Jones. The thing that concerns me is that these proposals appear to be placing us in a situation where instead of being able to determine what our net income is before taxes and tax on that, they're actually moving up somewhere in the middle. They're not exactly hitting the gross, but they're—it's a whole lot more than just the net that they're trying to get the tax on by forcing these accrual—like the thing with the replacement heifers or things like that.

Senator Symms. See, they're trying to get the money first 'cause, see, they're trying to get our money so they don't have to have the bigger interest bill to pay to get—in other words, they want to get it all in there the first—they go after these people like Ripley's businesses, the people that are accountants and lawyers.

See, there's a lot of those—the reason I don't think they'll get that passed is all those big law firms in Washington, DC—that's who they're after, too. See, they do the same thing. They use accrual accounting or I mean cash accounting. So they defer as much income as they can at the end of the year. They have to pay it eventually, but it gets deferred 1 year. So then they have that money, and the Government doesn't have it. The Government wants to get all those big accounting firms and law firms that use cash accounting also.

And it simply—the only reason I can see for it is because Congress hasn't got guts enough to cut spending. If they cut spending, they wouldn't have the Treasury dreaming up these kinds of things.

The fact is I've met a lot of nice people that work at the IRS, believe it or not; and I don't believe that they would all be harassing everybody so much if there wasn't so much pressure on them to raise more money. They're being told they've got to go out and raise money to pay their wages and five or six other people. So they're out there looking for every last drop of blood they can get out of that turnip.

Now, I got one other——

Mr. LOERTSCHER. Senator, you asked me a question. I didn't get a chance to answer it. You asked me what I felt about the elimination of the tax deduction.

Senator SYMMS. Yes.

Mr. LOERTSCHER. I have mixed feelings about that because if you're going to use that for a revenue raiser, it's great. But you look at it from the property taxpayer's viewpoint, they hate property taxes bad enough without an additional incentive.

But I am a personal believer in the property tax and local taxation. It's better taxation than Federal taxation; and if there is an incentive for local governments to tax and take some of that burden away from the Federal Government, you know, the local governments doing, you know, the—gosh, I can't even remember the terms.

Senator SYMMS. Well, federalism.

Mr. LOERTSCHER. Yeah, the New Federalism. If you're going to have that as your goal, to achieve that——

Senator SYMMS. Local autonomy.

Mr. LOERTSCHER [continuing]. Then more recognition, more incentive has got to be given for the local government to have the taxes in place.

Senator SYMMS. What would you estimate as far as the people in the area here of how many of them that have property taxes also itemize their income tax returns?

Mr. LOERTSCHER. I have no way of knowing that because——

Senator SYMMS. Just from what you run into people. Most farmers would itemize their tax returns. So they would be taking the deduction.

Mr. LOERTSCHER. I have about 15 clients that I do income tax for each year; and I think I've got——

Senator SYMMS. Sixty-five percent of the people don't itemize.

Mr. LOERTSCHER. Yeah. I was going to say I think I've got 5 of them that itemize deductions, 5 out of 15. So——

Senator SYMMS. That you do. You do some taxes, too?

Mr. LOERTSCHER. Yeah. So I don't see that—you know, it just isn't that, that big a deal. Although those who do take advantage of it, it just gives them one more hate incentive.

But if you're looking for an incentive for local governments to take over some of the responsibilities that they should be doing that the Federal Government is doing, then it should be left in place. That would be my comment.

Senator SYMMS. You know, I've been all over a lot on this issue because I basically believe what you're saying. I believe in the autonomy and sovereignty of each State, and they ought to be able to run their own affairs. And originally I cosponsored a bill that would disallow the Government from taking away that deduction.

Then the President came out with all this. And in light of all the other things, and pretty soon you start adding it up; and you start saying "Well, where are you going to go, and what is going to be the least detrimental to Idaho people? Which deductions can they give up?" But I appreciate your points of view.

Now, Dave, I want to come back to a question to you. You made a comment—and I'd ask this to the entire panel, but I'll start on you—about outside money coming in and tax shelters competing with bona fide farmers. You said—do you have any suggestion on that?

Now, you had one, Gordon, that the Grange has always said don't allow—to disallow more deductions in—what is the Grange's suggestion? And then I'd like to ask you for a comment on that.

Mr. Moir. The Grange has long supported the limiting of nonfarm income that can be sheltered by farm losses.

Senator Symms. In other words, you then would favor an amendment, say, to the bill that would say that your nonfarm losses have to be—your losses on the farm can only be used against losses that—I mean against earnings that you made in the farm?

Mr. Moir. Right, right.

Senator Symms. That's the basic thing you're saying?

Mr. Moir. Right.

Senator Symms. Do you want to comment on that, Dave?

Mr. Spencer. Yes. Maybe I'm flapping my trap without any real background on the deal. But from what I've been able to see, I think we need to get some of that outside money out of agriculture either by passing some resolutions or some such matter to stop individuals from putting this money into cattle, machinery, whatever and then leasing it out to the individual farmers.

Senator Symms. Well, how about the young farmer that can't afford to buy the land, but he wants to go out and start farming and leasing? Does that make him at a disadvantage?

Mr. Spencer. It could do. Could do.

Mr. Moir. Yeah.

Senator Symms. Or let's say Bruce over here decides he wants to sell his 40 acres; and by doing that and trying to say that we want to keep—and maybe there's a doctor here in town that's real successful that would like to buy 40 acres; but his accountant tells him that he can't, won't do him any good. So he says "I guess I won't invest in 40 acres. I'm going to go invest in a treasury bond or something, or I'm going to invest in a"—you see.

Tell me what you think about that. Tom, have you got a comment? 'Cause this really troubles me. I have people tell me this all the time, "Steve, you ought to be on the bandwagon to try to get all these outside investors out of agriculture." And then on the other side of it, I think what about the people that would like to sell out.

Mr. Loertscher. In agriculture I guess—maybe I have a warped view, but I think—I don't think of other farmers as being competitors; but I sure think about the doctor down the street that's got, you know, that's got some of his money tied up in agriculture. He doesn't have to make a dollar in agriculture; and in fact, he doesn't care. It's a good hedge.

Senator Symms. He cares after a while.

Mr. Loertscher. Well, in the long, long term. But he's got it for an investment whereas we're trying to make a living at it.

Senator Symms. Right.

Mr. Loertscher. And they're competitors. I guess if I'm a believer in the free enterprise system, I have to say let come what may. If we've got outside investors and we can't make it in agriculture, I guess that's the way it's going to go. I don't——

Senator Symms. We're going to make it 'cause people got to eat.

Mr. **Loertscher**. Definitely. But who's going to be left—the corporations that don't stand to lose anything in the near term who will be then dictating the prices of what you eat in the future; or is it going to continue to be the type of production we're used to, the family farmer who—who's in it to make a living now, not to make a killing in the future?

And I think, you know, I think the long-term goal of the President's proposals in the agricultural programs—it all comes down to the same thing, who do you want left when you, when you get to the—to that point, when agricultural prices and things turn around?

And it's the same in taxation. Who do you want left in farming? If you're going to tax us out of business, you're going to have a certain group of people left in agriculture, and it depends on who you want left. Are the tax breaks going to be there to keep the family farmer there, or are they going to be there for the corporate farmer or whatever?

Senator **Symms**. Dave.

Mr. **Spencer**. This is just strictly in my own experience. I had to start from absolutely nothing. It was about 1975 when I started. So, you know, I had to—like you say, the choice to deciding what I did for machinery. Well, at the time leasing was just getting started good, and back then it was more attractive to try and make do with used equipment than what I could go and lease something for.

Plus, if you get like your doctor or lawyer buying the ground next to you, maybe you'd like to buy that 40 that's setting right by you; but at $1,900 an acre, it won't pay for itself. Well, the doctor or lawyer can pay that $1,900 an acre or whatever. And maybe if his competition wasn't there, maybe that price for the ground would be more in touch with what agricultural products are bringing.

Senator **Symms**. Rip, you got any questions? I realize I'm getting behind here.

Mr. **Ripley**. No. I just wanted to say if any of them, you know, have any thoughts along this, I'm going to be back in Washington; and, you know, I'd like to hear from you if something comes up later.

Senator **Symms**. We want to keep close touch with the farming communities all over the State as to how these things are going to play out. I have an idea that after this recess, that there's going to be an awful lot of Senators and Congressmen come back to Washington that have got an earful from the farmers about this tax proposal.

And some of these things can be corrected. I mean I think—I don't believe that because of revenue neutrality—in other words, they're trying to say if you do away with something in the bill, you've got to come up with a plan how to raise the money back. I don't think that these things can be shown, with agriculture income the way it is, to have that big of an impact on the overall picture of the tax bill, most of these things, you know, most of the farming things.

But I really thank all of you. Did you have something else you want to say?

Mr. **Moir**. I have one other thing, Senator. I wonder if, like you say, the fellow down in the Treasury that formulated this stuff, they read—what was it—agriculture is only 2 percent of the population or something like that—if they weren't looking at this instead of the overall picture of how much the agriculture industry generates nationwide, you know.

Senator **Symms**. It's a big industry and a big employer in this country, one of the biggest.

Mr. **Moir**. Yes. But when you look at that figure—I don't know whether it's 2 or 4 percent.

Senator **Symms**. Very small number of people that actually are the farmers.

Mr. **Moir**. They think, well, shoot, these guys are insignificant, you know.

Senator **Symms**. But you take all the people that work over in Montpelier and Soda Springs area and mine phosphate and the whole service support industry is going to be affected. If something would affect farmers to use less fertilizer, that is not just going to—I mean that has a ripple effect in our communities around here.

There are a lot of people who make a living hauling fertilizer out to the fields; and if they don't do that—it's like that PIC Program. That really hurt the agriculture support industries. For whatever good it did some farmers, it hurt somebody else just about as much; and it hurt other sectors of agriculture. You know, it was—it may have been—had good intentions behind it possibly, but it certainly—there were a lot of people that don't have many kind words to say about it.

Well, I thank all of you very much. We've got to move on to the next panel.

Mr. **Mitchell**. Can I say something here for a minute?

Senator **Symms**. Sure.

Mr. **Mitchell**. As I understand it, all you're really doing when you make these tax changes is you're shifting the tax burden somewhere else.

Senator **Symms**. That's right.

Mr. **Mitchell**. It's different people that pay it, but the total tax is still the same.

Senator **Symms**. That's what revenue neutrality means. That's what's wrong with this idea.

Mr. **Mitchell**. So the bottom line is get the cost of government down so we all don't have to pay more taxes.

Senator **Symms**. Amen.

We're going to take a 5-minute break. The next panel can come up.

[A brief recess was taken.]

Senator **Symms**. The committee will come back to order. And I guess that somehow or another we got so carried away with the agriculture group there, we've gotten behind; and I apologize. I know the people on the third panel are getting nervous.

So we'll go right through and have all of you say what it is you came here for, and then we'll probably have some questions. But I'm going to start right on the end with Del Brewster because

Del—Del, you make your statement; and then at any time when you feel you have to go, you go ahead.

Mr. **Brewster**. OK. Appreciate that.

Senator **Symms**. But I want to welcome all of you to the committee, and I wanted to also say I thought the agriculture group had some excellent thoughts this morning. Go right ahead.

STATEMENT OF DEL BREWSTER, EXECUTIVE DIRECTOR, IDAHO FALLS CHAMBER OF COMMERCE

Mr. **Brewster**. OK. I appreciate the opportunity at least to come and give you a few of my thoughts. I'm Del Brewster, the executive director of the Chamber of Commerce in Idaho Falls.

And I'd like to, I guess, preface my statement by, as a representative of business, that we understand that there is always a give and take in any situation. And in reviewing the President's tax proposal, which I'd like to refer to section E of that proposal, there are several items that are, as I read it—fall into the give and take area.

And I know the overriding factor is, of course, business supporting the balancing of the budget; but in reviewing section E, talking about incentives for growth, I feel that business, small business in particular, are the risk takers. In many cases there have been incentives that the Federal Government has given for business to encourage them to start up a business regarding the SBA and other activities. But again, as the risk taker, there must be incentives maintained for business; and I guess in reviewing some of the incentives, I'm a little concerned about some of them.

But I think as far as some of the changes, I think some of the changes with the incentives—I think you should be attuned to maintaining economic development, maintaining a small business development. I think that we have to be attuned to stimulating new growth and development for small entrepreneurs.

I feel that some of the statements in here are a little unclear regarding special subsidies and the elimination of some of these special subsidies. So I would encourage, Senator, that you and your staff be attuned—and I understand as far as your willingness to aid business and your need to assist business in our dealings.

But I think you need to be attuned to the interest relating to the elimination of some of these subsidies. I, in reading through this, am very unclear in looking at the different industries that they're talking about here; and I would hope that these subsidies that may be eliminated would be thoroughly gone through before anything would take place. I don't know how to respond specifically to them because, in reading through here, I don't see any—it's very general as far as I understand. You can, you know, you can correct me if that's not right.

But I want you to understand that business is willing to give and take. We've been doing that for years; and we don't, we don't want to renege on any, any part of this.

We feel that the Federal budget should be balanced and—but it is necessary that we maintain some of the incentives that we currently have or some of modification of the incentives that we currently have because those are things that we need; and those are things that have promoted and fostered small business development in the past and will continue to in the future.

And I would encourage your staff to thoroughly research this particular area when it's dealing with elimination of certain incentives in some of these areas, but keeping in mind that we are willing to give and take, and you address yourself to the support of fostering small business growth and development through some incentives.

Senator SYMMS. OK. Well, thank you very much, Del. Appreciate your comments, and we—I'm just looking through that. I think I share, in the general sense, that concern. But we want to be sure that whatever's done, that the jobs in Idaho are kept as a priority because actually what makes business good is to have people have jobs so they've got income and they can buy things. And that's what makes the world go round, and that's really the bottom line.

Mr. Paul Kelly is the next witness with the Life—president of the Underwriters.

STATEMENT OF PAUL H. KELLY, PRESIDENT, NORTHEASTERN IDAHO ASSOCIATION OF LIFE UNDERWRITERS

Mr. KELLY. Yes, Mr. Senator, I appreciate the opportunity to be here today. I'm sure that our discussion won't be new to you, and I—as I understand your position on this, that you feel very much the same as we do regarding this.

Our particular reason for being here today is to voice our opposition to the portion of the President's tax reform bill that would impose current taxation on life insurance inside buildup, particularly in whole life insurance products. We feel like this is the wrong kind of a tax because one is the power to tax is the power to destroy. This tax would destroy both the ability of the insurance companies of America in capital formation as well as many of the only savings that people hold.

We feel also that it's discriminatory against older persons since the longer a person holds a life insurance contract, the greater the buildup, thus the greater the tax. And we feel that this would be a disincentive to the purchase of life insurance and thus shifting the burden of caring for our own to the Government. They have to be taken care of somewhere. We feel that it rightly belongs where it is and that the power to do this—that this taxation should not occur.

There's one other item. Now, unless anyone imagines that insurance companies that—do not now pay taxes—but let me just abuse the minds of those. Premium taxes on insurance sold in our State provide the fourth largest source of revenue to the State of Idaho.

Now, if the Federal Government transfers this taxation to itself while at the same time eliminating the credit or the taxes paid to the State will further complicate the problems that the State faces. I think that's what they call double whammy. They take away the incentives for the tax or the—well, they take away this writeoff, at the same time transfer the tax base to the Federal Government; or it could occur that way. I think that's the wrong way for it to work.

I think the McKernan-Ferguson Act is the—set up the State as the custodian for the taxation or for the control of life insurance products, and it should stay there. And I don't understand why the

Nation's Governors aren't more concerned about this particular item.

I also think that the bill itself fails to raise large amounts of revenue from this source for a considerable period of time, and it—it's the wrong kind of a tax. That's all I have.

Senator SYMMS. Thank you very much, and I'd just like to—I have this letter here that you wrote to Mr. Joe Cobb. I'd just ask your consent, Paul, to put that in the record at this point because that's an excellent letter, and it specifies each one of those points which we want that you just spoke to.

[The letter referred to follows:]

THE NORTHEASTERN IDAHO
ASSOCIATION OF LIFE UNDERWRITERS

Box 2006
Idaho Falls, Idaho 83403-2006

3 August 1985

Mr Joseph J Cobb
Joint Economic Committee
SD-G01 Senate Office Buildings
Washington, D.C. 20510

Dear Mr Cobb

We requested through Senator Symms office in Idaho Falls, an opportunity to take part in the hearings on tax reform to be conducted here August 13th. We have been informed that we need to send a summary of what we wish to discuss to your office for review.

Our aim is to voice our opposition to that portion of President Reagan's Tax Reform bill which would impose current taxation on life insurance inside build-up. We feel that this is the wrong kind of a tax because:

a. It imposes a tax on income in the absence of that income.
b. It is discriminatory against older persons, since the longer a person holds a policy, the greater the build-up, thus the greater the tax.
c. It would act as a disincentive for the purchase of life insurance, thus shifting the burden of "caring for our own" to the government.
d. It would be destructive of a resevoir of savings held by people to care for themselves and their loved ones.
e. It does not promote increased fairness and simplicity in taxation--which the President says is the basis for his reform bill, nor does it offer incentives for economic growth, when viewed from the perspective of the millions of people who are owners, beneficiaries and sellers of life insurance.
f. The bill fails to raise large amounts of revenue from this source.
g. It is our feeling that this is not simply a fight the insurance companies and its representatives have with this feature of the bill, the real losers in this fight are the people who hold the life insurance policies who bear the added burden of this tax.

Our association has membership who live in the Upper Snake River Valley from Blackfoot to Ashton, and from Arco to Driggs. We feel that we can complete of presentation in fifteen minutes. Those involved in making the presentation would be myself and Gerald Mitchell, our Legislative Chairman.

We would also like to publicly thank Senator Symms for his support of the resolution that urged the President and the Treasury Department to reject any tax reform proposal imposing a tax on the annual increases in the cash values of permanent life insurance.

ph 208-522-4228

Sincere Best Regards

Paul H Kelly

Paul H Kelly
President

Senator SYMMS. Jerry Mitchell.

STATEMENT OF GERALD B. MITCHELL

Mr. MITCHELL. Thank you, Senator. First of all, I'd like to just thank you for your support of the insurance industry and your taking the time to learn something about our industry.

I've been in the employee benefit area for the last 16 years, and I see some things within the tax proposal which concern me. In order to keep my comments to cover all the points I want, I apologize; but I'm going to read——

Senator SYMMS. No. That's fine. I think——

Mr. MITCHELL [continuing]. A poorly written copy, which you have.

A taxation of employee benefits will have a compounding effect that will ripple through the economy and cause problems that I haven't yet seen spoken of. The taxation of benefits will hurt employers, employees, State government, and the Federal Government and in almost in that order.

Let me just kind of go through those points. Employees first because they will be forced to pay a new tax on that money that their employers have been using to provide group insurance. Since the employee must now or under the tax law would then be forced to consider that money as income, which the employer has set aside for benefits—this could usually amount to $150 to $200 per month—and pay taxes on that money, that money—many will choose to use that money—to press their employers to pay them directly that amount of money in cash rather than to receive it in benefits.

This will be especially true of lower income employees who are concerned about the cash. They will be without health insurance because of that because many of them will choose to go without insurance in deference to receiving a larger paycheck. Now, in Idaho that's especially true because we don't have the same income on a per capita basis on an average as many of the larger industrialized areas.

They will be without health insurance and subject to possible financial disaster. In the case of a large medical expense, the county will be left with the task to provide protection in the absence of any other source. Now, you may be familiar and heard complaints about this within the State of Idaho. That's a real sore problem for us in Idaho.

Senator SYMMS. Yes.

Mr. MITCHELL. It's already a problem. The problem would be compounded severely because of this shifting away from personal responsibility or responsibility being provided by employers, and thus the county would be faced with a problem far beyond their ability to pay.

So far we've shown that employees and county governments would suffer under the proposed tax law change. Employers would suffer because they would no longer offer an insurance company a good risk selection. Now, I apologize for using some of the technical terms in here. However, I don't know how else to put it.

Many employers would choose to get insurance on their—employees would choose to get insurance on their own without group insurance, and thus they would be left with only those—the employer would be left with only those that were unable to qualify for an individual policy or have an outstanding or an obvious need for health insurance. The selection would be what we call antiselection against the insurance companies.

Insurance companies don't have a magical deep pocket that they go and get money from. It all comes from premium. This antiselection would cause insurance premiums to rise. The principle of spreading the risk would no longer exist. Thus insurance, group insurance, as we know it, would probably cease to exist for this very reason. It has a very devastating and debilitating effect on what's going on.

State governments would suffer because insured employees' benefits would no longer be attractive to either the employees or the employers and—or the insurance companies. Idaho would lose the tax revenue of 3 percent premium tax, which was just previously stated is one of the largest sources of income the State of Idaho enjoys.

That's pretty much the summary of my comments. I don't believe I've seen this particular argument put forward in any of the information that has been talked about as regards to the President's proposed tax law.

Senator SYMMS. Jerry, thank you very much. That hasn't been put forward in our other testimony.

Isn't it true that now there are people who are self-employed, they don't deduct off their medical insurance? You know what I'm talking about?

Mr. MITCHELL. Well, the tax law, the current tax law, does allow a corporation to deduct the premium for its employees. There are people who are self-employed who are not corporations who do not necessarily deduct their premiums directly. Depends on how they account—how they do their accounting. But the bulk of premiums——

Senator SYMMS. There are some people that have talked to me in the last few days, say, well, they've never gotten to deduct their own medical insurance——

Mr. MITCHELL. Premiums.

Senator SYMMS [continuing]. Premiums. Should we just expand that to everybody then, I mean based on your theory?

Mr. MITCHELL. Well, that would sure be nice from the point of view of marketing. It would be more fair because if we allow X, Y, Z corporation to deduct their premiums, why not allow Metro Insurance Service, Jerry Mitchell, to deduct his premiums. Yes, I think that would be more fair.

But I don't mean to expand an already deductible item, but I do think the bulk of people are covered by group insurance. And when the employer has a disincentive to provide that, then we have a crumbling of the system as it is now; and this statement, I hope, will demonstrate the domino effect or the rippling effect that this would have.

Senator SYMMS. I have heard from a lot of hospital administrators that have a very difficult time when they get a catastrophic case and somebody's not insured, and then the county commissioners finally get the bill. And the other patients that are in the hospital that can pay the bill, and then they have to raise the price on all them so they can work it out.

But you make an excellent point that hasn't been made. Thanks very much.

Mr. Bill Stephens.

STATEMENT OF W.J. STEPHENS

Mr. STEPHENS. Thank you, Senator. We realize our country's tax system is in a dilemma, a state of confusion. "If ever a law cried out for reform, this is it," IRS Assistant Commissioner Stanley Goldberg told reporters early this year: "I don't think neither man nor beast can master this." He was speaking about volumes of required tax changes by Congress in 1984. And during 1985 it bore out to be the truth with all the confusion the IRS had in trying to get the taxes straightened out.

Let's correct this dilemma, tax dilemma, now. I believe that all Americans want to support their Government with a tax that is fair for all. I do not support the November 1985, Treasury tax proposal. I do support the President's tax proposal to the Congress for fairness, growth, and simplicity as issued May 1985, but with a few modifications important to most Americans. Most of all, I prefer flat tax on earnings for all.

Limitations on interest deductions by individuals. I believe this should be increased from $5,000 to $10,000. The President's proposal is taking a large bite from middle taxpayers for second homes, autos, boats, trailers, and so forth. This will decrease sales and therefore reduce incomes made from these sales ending in a reduction of income tax collected.

Wealthy persons have no problems in this income because they have the money to subsidize themselves. But the $5,000 limit would have an economy—economic value to the lower income people. This would cut the interest credits that are due to the public and also lower the gross of manufacturers' products.

The President's plan calls for repeal of tax-free exempt status of industrial bonds. Private-purpose bonds had strict limits placed on them in 1980, 1982, and 1984. Further limits do not seem necessary or fair. Repeal will surely cut construction startups, particularly low-income rental housing, during times of recession and interest, high interest periods.

The President's proposal to capitalize interest as part of construction costs. This would pertain to interest paid or incurred on residential or commercial projects during the construction period. I believe that low-income housing interest would not be—I believe that low-income housing should not be included in this proposal. Housing has a terrible time coping with high demand one year and overbuilding the next. For sure this will raise housing costs, but limit many from homeownership.

Imputed interest. I believe it should never be a law. Our nation was built upon a free enterprise system and should stay that way. This is a big step toward taking that away.

President's proposal to tax disability retirement other than social security and disabled veterans. I do not agree with a tax on income that you have paid into regularly for a normal retirement plan. If you are injured and have to take an early retirement, you could get only about 40 percent of these benefits that you could have earned. The same holds true with social security payments.

Money—money paid for these future benefits in order to live with some peace of mind and off of welfare, now tax these—now tax these programs will put people on welfare. I do not believe this is what our Nation wants.

[The table attached to Mr. Stephens' statement follows:]

Total Impact of Reagan Proposal on After-Tax Homeownership Costs and Home Value by State

State	Average Home Price (Dollars)	Average Property Tax Rate (Percent)	Average Increase in After-Tax Homeownership Cost (Percent	Dollars)	Average Decline in Home Value (Percent	Dollars)
Alabama	$ 56,500	0.42%	2.8%	$ 200	−3.0%	$−1,700
Alaska	136,700	1.06	18.0	2,000	−16.5	−22,600
Arizona	85,000	0.71	9.0	700	−8.8	−7,500
Arkansas	57,800	1.29	4.1	300	−4.3	−2,500
California	121,700	1.05	11.6	1,200	−11.4	−13,800
Colorado	90,700	0.95	5.9	500	−6.3	−5,700
Connecticut	118,800	1.80	13.1	1,400	−12.6	−14,900
Delaware	79,600	0.76	8.7	700	−8.7	−6,900
District of Columbia	133,600	1.17	18.3	2,000	−16.7	−22,400
Florida	76,100	0.92	8.8	600	−8.7	−6,600
Georgia	83,700	1.16	9.7	800	−9.5	−8,000
Hawaii	158,300	0.60	17.3	2,100	−15.8	−25,100
Idaho	58,100	1.02	3.7	200	−4.0	−2,300
Illinois	95,800	1.72	7.8	700	−8.0	−7,700
Indiana	70,800	1.23	6.9	500	−7.0	−5,000
Iowa	68,800	1.67	7.5	500	−7.6	−5,200
Kansas	66,800	1.00	6.4	400	−6.6	−4,500
Kentucky	66,100	1.02	6.3	400	−6.5	−4,300
Louisiana	72,500	0.14	5.1	300	−5.3	−3,800
Maine	67,000	1.52	7.2	500	−7.3	−4,900
Maryland	94,200	1.38	7.0	800	−7.3	−6,900
Massachusetts	101,300	1.85	13.1	1,300	−12.8	−13,000
Michigan	79,900	2.88	12.0	1,000	−11.4	−9,100
Minnesota	81,300	0.85	9.0	700	−8.9	−7,200
Mississippi	61,400	0.82	3.5	200	−3.7	−2,300
Missouri	64,100	1.09	6.3	400	−6.5	−4,200
Montana	$ 48,600	1.17%	2.9%	$ 100	−3.2%	$−1,500
Nebraska	62,700	2.12	7.8	500	−7.9	−4,900
Nevada	93,800	0.68	5.2	400	−5.6	−5,200
New Hampshire	87,100	2.23	14.5	1,300	−13.4	−11,700
New Jersey	110,000	2.54	15.1	1,600	−14.3	−15,700
New Mexico	60,500	0.90	3.6	200	−3.8	−2,300
New York	95,300	2.66	9.8	1,000	−9.8	−9,400
North Carolina	65,800	0.96	6.2	400	−6.4	−4,200
North Dakota	70,800	1.26	7.0	500	−7.1	−5,000
Ohio	84,800	1.15	9.8	800	−9.5	−8,100
Oklahoma	73,800	0.89	8.6	600	−8.6	−6,300
Oregon	68,700	2.27	8.4	600	−8.3	−5,700
Pennsylvania	58,100	1.71	4.7	300	−4.9	−2,800
Rhode Island	86,600	2.01	14.0	1,200	−13.1	−11,300
South Carolina	78,100	0.85	8.8	700	−8.7	−6,800
South Dakota	56,200	1.75	4.7	300	−4.9	−2,800
Tennessee	71,900	1.17	6.9	500	−7.0	−5,000
Texas	85,300	1.36	10.2	900	−9.9	−8,400
Utah	85,800	0.97	9.5	800	−9.3	−8,000
Vermont	65,500	1.67	7.3	500	−7.4	−4,900
Virginia	91,900	1.28	6.7	600	−7.1	−6,500
Washington	80,300	1.03	9.3	700	−9.2	−7,400
West Virginia	54,400	0.68	3.1	200	−3.4	−1,800
Wisconsin	87,600	1.90	8.1	700	−8.4	−7,300
Wyoming	60,500	0.45	2.9	200	−3.2	−1,900

Source: National Association of Realtors

Copy from Realtor News

Senator SYMMS. Thank you very much. I was just looking at that table on the back there. Just going across there looking at Idaho, what you're saying is that the average home price in Idaho is $58,000; is that correct?

Mr. STEPHENS. Yes.

Senator SYMMS. And the property tax rate is 1.02 percent?

Mr. STEPHENS. Right.

Senator SYMMS. Average increase in after-tax home ownership costs, if you do away with property tax deduction, it's 3.7 percent or $200?

Mr. STEPHENS. Right.

Senator SYMMS. The average decline in home value is 4 percent or $2,300. That's—well, we'll keep that for our record, too. That's rather interesting. I want—it would be interesting to look and compare with the other States. I'll do that. Thank you very much. Is that DeeAnn?

Ms. MALONE. Yes.

Senator SYMMS. DeeAnn Malone.

Ms. MALONE. Yes.

Senator SYMMS. Welcome to the committee, and you go right ahead, please.

STATEMENT OF DeeANN MALONE, ACCOUNTANT, DATA-TAX, INC.

Ms. MALONE. Well, we're not one of the special interest groups, but we've been asked to speak to you as the accountants that handle all these special interest groups. We see some definite effects that this law has on some of these groups, and there's been some excellent points made by them.

We can see many good changes in this proposal, but simplification it is not. Reducing the number of brackets does not reduce the complexity of the tax return or the need for people like us to prepare it. It just seems to me that it's a shifting. They're giving on some items, but they're taking away on other items. And that just seems to be the most confusing for the average filer or the average taxpayer.

We've been preparing taxes for 21 years; and every time there have been massive changes in the tax law, we see the masses of the people are confused. It seems in this one that the largest cuts are for the very wealthy and for the poor. Good old middleman America is almost status quo. If anything, he, the middleman, sees the deductions being taken away that almost completely offset the reduction in the tax rates, such as the State and local taxes, ITC, energy credits, changing the child care from a credit to a deduction, the marriage adjustment, and the capital gains changes.

The tax system is so complex that overhauling it seems to only make it more complex. We see a definite increase in our business each time you change the tax laws.

Changes in depreciation, capital gains, some of the itemized deductions, child care, unemployment taxation, Social Security taxation, and travel expenses all affect the average taxpayer in Idaho; and these changes are confusing, to say the least, to just the average person.

There was a quote recently in the U.S. News & World Report; and I quote it: "Repeal of income averaging, the investment tax credit, and capital gains on depreciable property, such as livestock, and less generous depreciation rules would hit the farmer hard."

Many of the changes are long overdue and will have a good effect on our economy, as well as shut down some of the abusive tax shelter business. However, some of those very same changes have a very detrimental effect on small businesses and on the farmer.

As we discuss tax law with our clients in the course of preparing their returns, that becomes a topic that they like to express their opinion; and as they express their opinions to us, two definite facts come out. No. 1. They feel like corporations do not pay their fair share, and they feel like the wealthy have tax advantages that the average taxpayer does not have.

This letter appeared in the June 24, 1985, U.S. News & World Report. It was written by a man named Dave Reynolds from Clark Fork, ID.

> The Reagan tax plan should be entitled "The Tax Lawyers and Accountants Full-Employment Act." The claim of simplification is a bad joke, as illustrated by retention of the 1982 provisions for accelerated depreciation, subjecting it to an ad hoc tax, then taxing gain as ordinary income, subject to inflation adjustment.
>
> Simplification, and probably fairness, can best be accomplished not by enacting new tax laws, but by repealing them in reverse chronological order. The closer we get back to 1913, the better.

Our suggestions as accountants would be to quit making such massive changes so often in the tax law. Taxpayers never have time to get used to the law the way it is before it's changed. Consequently, it increases our business. It increases the need for us, and I'm not complaining about that. But as—I'm a taxpayer also.

Get the tax shelter promoters and not the taxpayers seems like a better answer to me; and as I've studied this whole law, I feel like that's the biggest thrust of this law, they're after that tax shelter business and the farmers. And some of these others are getting caught in the changes in those particular laws.

We feel that vigorously enforcing the registration of tax shelters is probably a better avenue than hitting at the taxpayer.

Senator SYMMS. Thank you very much. You made one statement about people—your clients normally say that they think wealthy people don't pay taxes and corporations don't pay any taxes?

Ms. MALONE. They feel like they don't pay their share. That's the consensus of the general public.

Senator SYMMS. As an accountant, how do you feel about that?

Ms. MALONE. We're incorporated obviously, and so I realize that we don't have as many tax advantages as the individual feels like we do.

But the individual person that works for wages out there does not have the tax advantages of a corporation. People do not have the tax advantages of those who are able to afford to purchase tax shelters or tax sheltering type items.

And I do feel like those parts of this proposal are excellent, and I feel like that really was the direction they were headed in when they did some of this. But it's, it's too far-reaching. It's touching too hard on people like the farmers.

Senator SYMMS. Thank you very much.

Ms. **Malone**. I believe——

Senator **Symms**. Ray. I think Ray had a comment to make there.

Mr. **Malone**. Yes. My wife has more or less been the spokesperson for us; but there's a few things I would like to say, that I think the people would like to see the budget balanced above all.

But I know that when we first started in business 6 years ago, ITC meant a lot to us. It more or less kept the doors opened for us when we first started in business. And we do right at 2,000 tax returns a year, and we have a lot of people that are just starting business every year. And ITC does mean a lot to them.

And as far as depreciation—what is it—3 years ago they brought in ACRS depreciation. There's going to be a lot of tax returns that's going to have all kinds of different kind of depreciation on it; and like I say, those people that we're doing their returns before, it's going to help us. But it's going to be a mess for us, too.

So that's—and the farmers, listening to the farmers this morning, as far as I'm concerned, they had some very good points.

Senator **Symms**. And you say also that you think we ought to reduce spending——

Mr. **Malone**. Yes.

Senator **Symms** [continuing]. Before we worry about the Tax Code. And I guess, DeeAnn, I take it that's what you were saying, too?

Ms. **Malone**. Yes.

Senator **Symms**. Bill?

Mr. **Stephens**. I agree with you.

Senator **Symms**. What do you say, Jerry?

Mr. **Mitchell**. Absolutely. I think that's the basis of the problem. As I see this revenue or this proposed program, I see it as a revenue-raising measure, which is designed to help offset our problem. The problem isn't to raise more revenue. Our problem is to reduce the expenditures, and then they wouldn't have to worry about the other.

Senator **Symms**. What would be a real nice smooth trick for Washington would be to convince everybody they were going to lower their tax rates by having them give up all their deductions; and once they've given up all their deductions, you go back and start raising the rates back to make up the difference. And then where are we?

The problem still is Federal Government is spending $950 billion. Now next year they're thinking about spending $1 trillion, and that's our problem. That's 25 percent of our GNP, and that means that the Government is allocating $1 out of every $4. And they aren't balancing the budget.

You know, we tend to talk about the deficit and the budget is not balanced. But they're borrowing that money, and we're liable for the debt as individual Americans. And that's the problem. So we're being put in debt really without permission, so to speak. But we're obligated to pay it, and there's no way out without paying it.

Mr. **Mitchell**. I see this as a, this tax proposal, tar-baby issue because the real problems that everybody in America is concerned with are the problems that are created by the substantial or the great debt that we face. This simplification of the taxes is a nice thing to have, but there's a lot of nice things to have. Our real problem is the debt.

Senator SYMMS. Thank you all very much for your testimony and your patience to wait here this morning. It was excellent testimony, and I appreciate having it.

Our next panel is Harold Davis, Ruth Lathrop, and Dwight Whittaker. Would you come right on up to the table, please.

OK. We'll start right out with Harold Davis. Harold, welcome to the committee. Nice to have you here this morning.

STATEMENT OF HAROLD W. DAVIS, PRESIDENT, ELECTRICAL WHOLESALE SUPPLY CO., INC.

Mr. DAVIS. I appreciate this opportunity.

Senator SYMMS. I don't think that's Del Brewster on the end over there.

Ms. LATHROP. I'm Ruth Lathrop.

Senator SYMMS. Right.

Mr. DAVIS. Thank you, Senator. Appreciate the chance of meeting with you today. I'm Harold Davis. I'm president of Electrical Wholesale Supply. This is just a little quick outline. We currently have 42 employees in 5 cities or 5 locations in 4 cities in eastern Idaho with approximately $10 million in annual sales. I serve currently on two international advisory board corporations for the Square D, and GET Lamp, and also for RTE Corporations, a national manufacturing.

Before I address the point of tax reform, I would like to talk just a moment about the reduction in spending because that undergirds some of our thinking.

The recent issue of the Post Register indicating the propensity with which we've had to borrow money since the 1980 spectrum is, of course, of real serious concern to us as a corporation because increasing debt service either as a percent of gross national product or as a percent of total budget is an alarming consideration.

And as a business, one of the things that causes us to be very restrictive in our growth consideration is the expected cost of money. We watched too many businesses in the last half dozen years be caught with escalating debt service cost and then find themselves in bankruptcy.

And since we're not able to do that, we're trying to hold our debt service cost, our debt to net worth, extremely low because we do not feel that these kinds of debts and the Federal Government's requirements for credit will do anything but increase the cost of money at some point in time.

Another interesting point in that same newspaper, an indication the Union Pacific Railroad closing 16 offices or agencies throughout the State of Idaho. I suppose as a corporation we tend to feel that it's best to cut as long as you're cutting somebody else, and so today I'd like to talk about cutting things in the State of Idaho.

We would favor, for instance, Congress adopting many of the recommendations of the Grace Commission, particularly those things as it relates to closing of post offices and military bases that have long since served their need; and that could begin in the State of Idaho as long as it is evenhandedly carried out across this country.

We favor closing the SBA in its entirety. We think that that's unnecessary and feel that corporations—the profit motive is sufficient to have gotten us started. We frankly are very pleased about the fact we've not applied for an SBA loan, and I hope we don't ever have to.

Now, relative to tax reform itself, we agree with the President that the existing system is unfair, that it is too complicated, and it does impede growth. Those very basic points we do concur.

As the proposal moves through Congress—and it will be modified and adapted as various special interest groups apply their leverage upon the Congress—we would hope that you, Senator, and others would resist that and that the goals would be kept in mind. We don't necessarily favor or disapprove of any particular part of it.

The thing that's of concern to us is that an even hand be used across all corporations. How true it is in Mr. Iacocca's book about Mr. Ford, president of Ford Motor Co., only recently starting to pay taxes. How true it may be that IBM and General Electric Corp., their Federal tax bills in relationship to net income before taxes—we don't really know.

We happen to enjoy some benefits of the present tax system. We don't particularly want to see those go or stay. Our position is that if, for instance, they are repealed, that they are repealed evenly across the board. We'll stand with any corporation and pay our fair share as long as all corporations pay their fair share so that—for instance, in the valuing of inventory at year end, a significant point to us is the ability to change those fivo dollars to lifo dollars. If that should be taken away, all we would ask is that it be taken away from everybody and not be left for a select few.

And so the testing that we've tended to do with our CPA's relative to the chart shown on table 15 in the President's proposal—and mind you, we've only done some very minimal testing—tends to reveal that this chart is a bit optimistic. The tax savings are greater. In other words, the—our concern is that the revenue coming into the Federal "troughers" as a result of these kind of data would indicate that it would probably be less income than what's anticipated.

We hope that when tax simplification is finished, that it is more simple; and that in fact the gross revenues to the Federal Treasury are not more nor less, but essentially the same; and that we can get back to fiscal sanity by having a balanced budget as quickly as possible.

Senator SYMMS. Thank you very much for an excellent statement, Mr. Davis.

Jennie Ruth Lathrop, we'll hear from you now.

Ms. LATHROP. Lathrop.

Senator SYMMS. Lathrop, I'm sorry. Having a hard time here; please proceed.

STATEMENT OF JENNIE RUTH LATHROP, RETIREE

Ms. LATHROP. Well, I appreciate the fact that I can speak today; and I'm a little bit overwhelmed by it because when I wrote those letters, I didn't dream that I'd have an opportunity to speak. I am speaking mainly from the standpoint of a single retired person and the concerns that I have about income tax.

One of the main thorns is that though I am single, I cannot claim head of household. I have just as much expense in maintaining a household as anyone else; and in many cases I have more expense because where other people can do it themselves, I have to call in a repairman. And other single people who are in my same situation, we've discussed this many times.

Senator Symms. Yes.

Ms. Lathrop. Another concern that I've had since I retired is Medicare. Before I retired, my school district paid my medical expenses. Then when I became 65, I was switched over to Medicare. Almost every claim that I've submitted to them, although it's a just claim, it comes back with a statement, "We're sorry. We don't pay on this" or they pay a very minimal amount. And when I go to the doctor, I'm asked to pay the entire bill right there. So you can see that I have qualms about paying any more income tax.

And I'm also concerned about this proposal that we cannot claim State and local taxes because I have so few deductions that if I cannot claim my State and local taxes, I know that I'm going to be paying much more income tax; and there are other people who feel much the same about it. I feel I'm speaking for some of them today, too.

I would like to make the point, too, that I've been listening to all the news and watching the media; and I have the feeling that though this new tax reform is to simplify the income tax, I have the feeling that we may be paying more income tax.

And I get that feeling from listening to the news about the bad loans that have been made to other countries that are not going to be repaid. In many instances, I hear that they cannot even pay the interest on it. Now, in raising a family by myself, I found that if you're wise, you take care of the people at home first before you make any loans because you just might not get it back.

And I'm concerned, too, about all of the money that we're spending on weapons, and I'm not sure that we're doing it in the most economical way. All this makes me think that maybe we will be paying more income tax; and as a single person, I'm really—retired person, I'm really concerned about that.

And, too, I'm wondering—if we do pay more income tax, then our purchasing power will be decreased; and how is this going to help our economy? I'm just very much in favor of less taxes. I'm certainly not in favor of any more.

And I appreciate very much your letting me speak today.

Senator Symms. Well, Jennie, I appreciate your excellent statement very much. I think you've focused in on some of the key problems that we in the Congress are faced with and are not winning the battles against. Or at least we're maybe making a dent in it, but we're not winning it to the degree that I'd like to see us do.

Ms. Lathrop. Yes, I know.

Senator Symms. But I appreciate your statement.

Ms. Lathrop. Thank you.

Senator Symms. That's an excellent statement. Thank you so much.

Ms. **Lathrop**. Senator Symms, I'd like to tell you that I appreciate the courtesy with which your secretary answers when I have inquiries, and I appreciate receiving the mail from you, too. And I think you're telling it like it is and doing a good job, and I really appreciate it.

Senator **Symms**. Thank you. We all appreciate Dixie Richardson, and she's right here today. And she couldn't find me at the airport this morning, but otherwise that's the first mistake she ever made.

Ms. **Lathrop**. Thank you.

Senator **Symms**. Now, if it had been New York City, I might have understood it; but in Idaho Falls she couldn't find me. Now we'll be glad to hear from our next witness, Dwight Whittaker, director of the Development Workshop. And, Dwight, I see you have a presentation.

Mr. **Whittaker**. Yes, sir.

Senator **Symms**. I hope you can kind of summarize it.

Mr. **Whittaker**. Yes, I can.

Senator **Symms**. And we can put your entire statement—your entire seven or eight pages will be in the record.

STATEMENT OF H. DWIGHT WHITTAKER, EXECUTIVE DIRECTOR, DEVELOPMENT WORKSHOP, INC.

Mr. **Whittaker**. All right. Thank you very much. Senator and members of the committee, it's a real honor for me to be here today; and we appreciate the opportunity to have such an experience in our own community.

I'm here representing Development Workshop as a nonprofit organization, but also the other nonprofit organizations in Idaho and perhaps throughout the United States, but especially the 13 other rehab facilities within the State of Idaho.

Our Nation has had a long history of encouraging charitable contributions for nonprofit organizations by providing significant tax incentives to the private sector. Beneficial results have occurred to the country as a result of furthering the work of nonprofit organizations and obviously helping to relieve some of the tremendous responsibility that the Government would have to pick up were that not the case.

We have some concerns about four major changes that are being presented by the Treasury Department and would like to discuss those with you. The first, under the Treasury's proposal, charitable contributions would be reduced, should be, to only the extent that they exceed 2 percent of the taxpayer's adjusted gross income. Currently there is no minimum.

An example taken from an analysis by Prof. Larry B. Lindsey of Harvard University would demonstrate that a couple making $30,000 annually that donates approximately—or donates $600 to various nonprofit organizations would have a deduction today of about $200. Under the Treasury's plan, they would have no deductions.

The Treasury's rationale is that the 2-percent threshold is inappropriate to subsidize gifts that would be made anyway. The Treasury claims that those who give only the modest amounts are not much affected by tax considerations.

On the contrary, many analysts in the nonprofit sector feel that 2-percent floor would have a powerful disincentive for individual giving. Nonprofits which depend upon direct mail fundraising are most likely to be hurt by this change. Most contributions are made by people in the middle-income category. The Treasury's proposal would tear asunder their donative intent.

Our experience at Development Workshop supports the premise that the 2-percent ceiling would in fact be a disincentive for Americans to contribute to nonprofit organizations. If you'll refer to the yellow sheet at the back of the proposal, which we refer to as appendix A, gives some statistical analysis that we have experienced here in Idaho through the efforts of the Idaho Legislature.

A tax—Idaho State tax credit was made available to individuals or corporations who contributed to nonprofit organizations or rehabilitation facilities specifically and, of course, our educational institutions in the State of Idaho. The basis for their contributions were that they were allowed 50 percent of their total contribution as a tax credit. So for corporations, a maximum of $500 credit was available, and for individuals a $100 credit was available.

The appendix shows in 1922 or—excuse me—1982, the gifts that were received by December of that year to Development Workshop were $5,286, 79 individuals contributing. Then the legislation was—became in effect in July 1, 1983, and you can see the results of the contributions made in 18—or by December of 1983, that 177 people made contributions, and the contributions almost tripled then in dollar amount. And we see that trend continuing, maintaining itself in the foreseeable future.

This, we recognize, is a very small-scale example; but nonetheless, I think it points out that given some incentives and a right cause, that individuals are willing to help support the work of nonprofit organizations.

The second point is that charitable deductions for gifts of appreciated properties would be allowed only to the extent of actual cost plus a factor for inflation or actual market value, whichever was less. The actual cost plus inflation would usually be much less than the market value. In most cases, then taxpayers could no longer deduct the market value. They can under the present law.

Many colleges, universities, others who go after large foundations, hospital organizations, and so forth would find that this would be extremely devastating to their program for raising funds within the community.

The proposed changes in the treatment of appreciated property would deny to charitable organizations an opportunity to share in the successful investments of the country's growth. It also seems to us that the proposed action by the Treasury would be counterproductive to President Reagan's plan to reduce Government involvement and to increase the involvement of the private sector within nonprofit organizations.

I'll skip over that example that's listed there in my prepared statement. But again, the emphasis by many individuals—studies have been done that indicate that there would be a 30-percent decline in gifts in appreciated property to colleges particularly, and that represents 40 percent of the total dollar amount that might be given.

The Treasury Department again feels this is an artificial incentive for giving, but it is a real incentive that today many individuals are taking advantage of to help pick up some of the responsibilities that would have to be borne by the Government.

No. 3, under the Treasury's proposal, the charitable deduction for nonitemized taxpayers would be repealed, again, under the interest of simplification in claiming that charitable deduction provides difficult enforcement problems for the IRS and these again are not real incentives for contributing. If a person has donative intent, they will contribute anyway.

Once again citing our little case study here, we find that incentives do in fact increase contributions; and the taxpayers will take advantage of that.

The fourth point has already been discussed this morning by representatives of the insurance industry, and let me just briefly say that the proposed taxing of the increase in cash value or life insurance increases are of concern to us as well. When life insurance is used as a means of providing contributions to nonprofit organizations, this would be a very large disincentive to individuals.

And let me say that life insurance is used quite extensively in providing incentives or providing contributions to nonprofit organizations, particularly colleges and universities; and that this kind of activity would certainly decrease the amount of contributions received by nonprofit organizations.

In summary, most experts see devastating results for nonprofit organizations from these four tax changes. Again, in my prepared statement, a study by Duke University economist Charles T. Clotfelter projects that the Treasury's proposal would cause a 20-percent reduction in charitable giving, a lost of $12 billion a year.

I think in light of the decreases in Federal and State moneys which are available which are not happening and are no longer coming to nonprofit organizations, we implore you not to take away any incentives for the private sector that would increase their participation in the valuable and necessary work of nonprofit organizations throughout the United States.

We would have to say that, generally speaking, under the Reagan administration, we have had an increase in Federal assistance because it is employment-oriented versus a straight dole. And we find this kind of activity most beneficial to the individual and also most beneficial to the community because it's results oriented and set up so that individuals receive appropriate training and are then placed back into the mainstream of society.

So there may be some, some issue that nonprofit organizations are not receiving as much today as they had previously, but it's been our experience that it's just the opposite given the right frame of mind that there are more dollars available to help disabled and other individuals than there has been previously.

Appreciate the opportunity, and I will try to answer any questions you might have concerning this.

[The prepared statement of Mr. Whittaker follows:]

PREPARED STATEMENT OF H. DWIGHT WHITTAKER

IMPLICATIONS OF TAX REFORM PROPOSAL

Our nation has a long history of encouraging charitable contributions for nonprofit organizations by providing significant tax incentives to the private sector. Beneficial results are achieved by nonprofit organizations as a result of those charitable contributions.

The Treasury Department's tax reform proposal, made primarily in the interests of tax simplication, has important implications for those nonprofit organizations.

The Treasury Department has proposed four major changes in the tax code concerning charitable contributions. We would like to comment on each proposed change.

1. Under the Treasury's proposal, charitable contributions would be deducted only to the extent that they exceed two percent (2%) of the taxpayer's adjusted gross income. Currently, there is no minimum base.

   An example, taken from an analysis prepared by Professor Larry B. Lindsey of Harvard University, is as follows:

   > A family earning $30,000 annually, that donates $600 to their church, United Way, hospice and other causes, can now receive a reduction in taxes of approximately 30% of these gifts, or $200. Under the Treasury plan, they would have no deductions.

   The Treasury's rationale for this two percent threshold is that is is inappropriate to subsidize gifts that would be made anyway. The Treasury claims that those who give only modest amounts are not much affected by tax considerations.

On the contrary, many analysts in the nonprofit sector feel that the two percent floor would have a powerful disincentive for individual giving. Nonprofits which depend on direct mail fundraising are most likely to be hurt by this tax change. Most contributions are made by people in the middle income category. The Treasury's proposal would tear asunder their donative intent.

Our experience at Development Workshop supports the premise that the 2% ceiling would in fact be a disincentive for Americans to contribute to nonprofit organizations. An examination of Appendix A reveals the affect of tax incentives on charitable contributions to Development Workshop.

Immediately following the adoption by the 1983 Idaho Legislature, of an Idaho State Income Tax Credit for contributions made to nonprofit rehabilitation facilities we saw a significant increase in the numbers of contributors as well as the total dollar amount received. An ammendment to Chapter 30, Title 63 of the Idaho Code specifically allows individual and corporate tax payers an Idaho State Tax Credit equal to 50% of the aggregate amount of their charitable contributions not to exceed $100 for an individual and $500 for a corporation within a tax year.

Appendix A shows that the number of contributors more than doubled in December of 1983 when compared to the prevous period ending December 1982. Of significance is that the dollar amount contributed almost tripled from $5,268 in December 1982 to $16,033 in December 1983. That trend has continued through December 1984.

Although it is on a small scale, we feel our data supports the fact that while people have donative intent and while they do in fact support many good causes, unless and until there are "real tax incentives", the American public is generally reluctant to step forward and support nonprofit organizations. But when given such "incentives", they will do so readily and voluntarily.

2. The charitable deduction for gifts of appreciated property would be allowed only to the extent of the actual cost plus a factor for inflation, or to actual market value, whichever was less. The actual cost plus inflation would usually be much less than the market value. In most cases, then, taxpayers could no longer deduct the market value, as they can under present law.

As Independent Sector points out: "Many of the Leadership gifts for annual and special appeals of colleges, museums and hospitals and most of the gifts which form foundations are gifts of stock and property that have grown far faster than the economy generally. The proposed changes in the treatment of appreciated property would deny to charitable organizations an opportunity to share in these successful investments in the country's growth."

It seems to us that the proposed action by the Treasury would be counterproductive to President Reagan's plan to reduce government's involvement and to increase the involvement of the private sector within nonprofit organizations.

An example of the effect of this change in tax policy is illustrated below:

> If an individual's initial stock investment in a new company was $10,000 in 1950 and that stock has had a growth experience something like IBM, Xerox, Gannett or other successful ventures, the stock today might be worth $10 million, which

> the individual could give to a College, a home for the aged or to start a foundation for children with developmental disabilities. However, under the Treasury plan, he or she could not deduct the fair market value of $10 million, but only the original cost plus a factor for inflation, which might mean that the gift would be worth only a deduction of $200,000. I think you can see there would be far less incentive to transfer the assets to a charitable organization.

According to Bruce R. Hopkins, editor of The Nonprofit Counsel, "For colleges, universities, schools, hospitals and other institutions and organizations that rely heavily on gifts of securities, real estate and the like, the appreciated property gift rule change would likely prove to be disastrous. The existing law is the single-most important incentive...underlying charitable giving."

The Lindsey study, mentioned earlier, estimates that if this point of the proposal were passed into law, there would be a 38 percent decline in gifts of appreciated property to colleges, and that appreciated property represents 40 percent of all individual gifts and a significantly higher percentage of larger gifts.

The Treasury's reasoning for proposing this tax change is that the deduction is an "artificial incentive" to donate property rather than money. We submit to you that this is not an "artificial incentive" but a real incentive that is affective today and will remain valuable to nonprofit organizations for years to come.

3. Under the Treasury's proposal, the charitable deduction for nonitemizing taxpayers would be repealed.

Again, the Treasury has proposed this change in the interests of simplification, claiming that the charitable deduction provides "difficult enforcement" problems for the IRS. The Treasury also maintains that the charitable deduction has little or no effect on the amount of contributions--a premise contradicted by data gathered by Independent Sector which shows that the charitable deduction stimulates gifts. This premise is also contradicted by our data as found on Appendix A, which we reviewed earlier.

4. The Treasury Department is proposing that a tax be levied each year on the increase in the cash value of life insurance even though the policy is not surrendered or paid out during that year. It would also require that the policy owner pay taxes on any policy loans even though this is not an income but a loan on which they already pay interest. Furthermore, under the Treasury Department's proposal, even this interest may not be tax deductible.

The concern that nonprofit organizations have with the Treasury Department's proposal which addresses the taxing of cash value, policy loans, etc. is that life insurance will no longer become a meaningful means to plan ones estate. Life insurance will certainly not remain as useful a tool in obtaining charitable contributions from the private sector.

Life insurance is a very flexible instrument that can be utilized by individuals in every income level to assist their college, university, rehabilitation facility or other nonprofit organization in achieving their stated goals and objectives. Once again, the Treasury Department's proposal to tax life insurance income would be counter productive to this administration's intent to reduce government's involvement and increase private sector participation.

In summary, most experts see devastating results for nonprofit organizations from these four tax changes. A study by Duke University economist, Charles T. Clotfelter, projects that the Treasury's proposal would cause a 20 percent reduction in charitable giving--a loss of $12 billion a year. He has broken down those losses in terms of the type of organization, as follows:

TYPE OF GROUP	PERCENTAGE OF LOSS
Religion	18 Percent
United Way	24 Percent
Health	24 Percent
Arts & Culture	25 Percent
Higher Education	27 Percent

Though the relationship of taxes and giving is important, as illustrated by the Clotfelter and Lindsey studies, Independent Sector points out that people "do not give to the causes of their choice because of tax considerations. The larger motivation is related to helping others and improving communities. However, the availability of the deduction does influence the size of enough gifts to represent a 31 percent increase beyond what would be contributed if there were no deduction."

In conservative Idaho, we feel the tax incentives have doubled our contributions. The removal of these incentives would cut our contributions in half. That would jeapordize some of our programs.

The Treasury proposal does include three inducements to increased giving, but by their own calculations, all three would be outweighed 25 to 1 by the reductions in incentives discussed above. For example, the Treasury proposes lifting the ceiling on how much an individual can give of his or her annual income from the current maximum of 50 percent to no limit. Brian O'Connell, president of Independent Sector, pointed out that he "didn't really think the Treasury was serious in believing that many Americans could give more than 50 percent of their income." The current average of percentage of income donated is two percent.

Also, the Treasury would now allow corporations to give more than the current limit of 10 percent of their income, but again, O'Connell pointed out that "the national average is well below two percent, so the higher ceiling is not likely to have much impact on giving.

There are a number of other points in the Treasury proposal of interest to nonprofits. For instance:

- The proposal would limit the amount of health and accident insurance that can be provided by an employer tax free to an employee.
- The proposal would tax scholarships and fellowships to the extent they exceed tuition.
- The proposal would repeal exclusions for employer-provided group life insurance, housing and housing allowances for ministers and death benefits.

In light of the decrease in Federal and State monies which are available to nonprofit organizations, we implore you to not take away any incentives from the private sector that would increase their participation in the valuable and necessary work of nonprofit organizations throughout the United States.

Thank you again, Senator Symms and Members of the Joint Economic Committee, for this opportunity to present testimony. I will attempt to answer any questions you may have.

References

"Charities Lable Treasury Contributions Proposal 'Scrooge-Like'," Independent Sector News Release, December 17, 1984. (Independent Sector, 1928 L Street, N.W., Washington, D.C. 20036).

"Independent Sector's Position on the U.S. Department of Treasury's Contribution Proposals Contained in: 'Tax Reform for Fairness, Simplicity and Economic Growth.'"

FRM Weekly, December 19, 1984. (Pub. Fundraising Management Magazine, 224 Seventh Street, Garden City, New York 11530).

LRC-W Newsbriefs, Series #12. (Dupont Circle Building, Suite 823, 1346 Connecticut Avenue, N.W., Washington, D.C. 20036).

The Nonprofit Counsel, January 1985. (Pub. Charitable Publications Co., Inc., P. O. Box 40727. N.W., Washington, D.C. 20016).

The Nonprofit World, January-February 1985. (6314 Odana Road, Suite 1, Madison, Wisconsin 53719).

Tax Exempt News, January 1, 1985. (Pub. Capitol Publications, Inc., 1300 North 17th Street, Arlington, Virginia 22209).

Taxwise Giving, December 1984, Vol. XXIII, No. 4. (13 Arcadia Road, Old Greenwich, Connecticut 06870).

APPENDIX A

THREE-YEAR DONATION COMPARISON

AMOUNT	DEC. 1982 # GIFTS	DEC. 1982 $ AMOUNT	DEC. 1983 # GIFTS	DEC. 1983 $ AMOUNT	DEC. 1984 # GIFTS	DEC. 1984 $ AMOUNT
$10,000					1	10,000
$ 5,000			1	5,000		
$ 2,500					1	2,500
$ 1,000			1	1,000	2	2,000
$ 500	1	500	2	1,000	2	2,000
$ 300					1	300
$ 250	1	250	1	250	1	250
$ 200	6	1,200	18	3,600	24	4,800
$ 175	1	175				
$ 150	1	150	3	450	1	150
$ 125					1	125
$ 100	17	1,700	21	2,100	23	2,300
$ 80	1	80				
$ 75					2	150
$ 60	1	60				
$ 50	11	550	15	750	17	850
$ 35			1	35		
$ 30			1	30		
$ 25	16	400	33	825	33	825
$ 20	1	20	12	240	5	100
$ 18			1	18		
$ 15	2	30	27	405	15	225
$ 10	10	100	27	270	16	160
$ 8	1	8			1	8
$ 5	9	45	10	50	6	30
$ 4			1	4		
$ 3			2	6		
$ 2.50					1	2.50
$ 2					1	2
$ 1					1	1
TOTALS	79	5,268	177	16,033	155	25,778.50
AVERAGE GIFT		66.68		90.50		166.31
GIFT LESS $10,000 GIFT					154	102.46

Senator SYMMS. Thank you very much. Just one question now. On that part where you said if a person had put $10,000 in a—the example on page—where was that?

Mr. WHITTAKER. Yes.

Senator SYMMS. Well, if they put $10,000 in and it came out—you know, they'd made an incredible investment and it was worth—well, you've got down here $10 million. They donate that stock to the foundation or whatever, to the school or charity, then they can't take a $10 million—they could sell it, get cash, and give them the cash, couldn't they?

Mr. WHITTAKER. That's correct. They would have to then pay the capital gains.

Senator SYMMS. Wouldn't have to pay it if they gave it away, would they?

Mr. RIPLEY. Yeah, they would.

Senator SYMMS. They would?

Mr. RIPLEY. That's what they're getting at.

Senator SYMMS. Well, I don't blame them. You mean if they want to give them the stock, they can't take off the market value is what you're saying?

Mr. WHITTAKER. That's correct. Let's assume their initial investment was $10,000 and then this example: If it happens to grow to be $10 million, then their cost basis is $10,000. And they would have—if they sold the stock, they would have to pay the difference between the $10,000 and the $10 million through capital gains.

Senator SYMMS. OK. If we got this tax right down to below 20 percent for the top rate, do you think then that you'd be able to go out and compete for contributed dollars because the people would be talking about, say, 19-percent dollar?

In the Hall-Rabushka tax plan, they propose to do away with charitable contributions, but they come right back—and in fact, Mr. Hall and Rabushka have earned their livelihood from charitable contributions at the Hoover Institute all their lives. They work at that institute at Stanford. They maintain that—at a 20-percent rate, they estimate that people would still contribute generously; but at a 35- or 40-percent rate, whatever this may come out, you're concerned about it, in other words?

Mr. WHITTAKER. That's right.

Senator SYMMS. So if we ever devise a flat tax or a simple tax that actually got the rates down there, then you think you'd be all right? You'd be nervous about it, but you'd have a better shot at it?

Mr. WHITTAKER. Right.

Senator SYMMS. See, this may not end up at 35 percent. This could end up at 40. I think there's a general belief in the country that if you lower tax rates—and I believe this myself—then you do away with the incentive for people to invest into the so-called tax shelters that everybody's distressed about. And that incentive goes with it.

Well, I thank you very much. That was an excellent statement. We've got the entire statement.

Do you have any questions, Rip?

Mr. RIPLEY. Well, I had a question about that 2 percent. I don't find that here in the law—I mean in the proposed law.

Senator SYMMS. I didn't understand that either.

Mr. **Ripley**. Can you point that out to me maybe with the section?

Mr. **Whittaker**. I would have to pull the section, and maybe what I should do is just correspond with you directly. Would that——

Senator **Symms**. What do you mean by the 2 percent?

Mr. **Ripley**. That would be all right.

Mr. **Whittaker**. Well, the intent is that the maximum ceiling that would be available would be—the maximum that an individual could deduct would be 2 percent of their adjusted gross income, and what we may be talking about is the total of the deductions that [illegible] incorporated in the law that would still be allowed might equate to a 2-percent factor. That's the maximum that could be—would be deductible. And then as in the case of the $30,000 annual income, they could—basically they would have no deduction under the new proposal.

Senator **Symms**. Whoever wrote that didn't read the Good Book, did they? It says 10 in there.

Mr. **Whittaker**. That's right.

Mr. **Ripley**. I mean I don't know of any such provision in here.

Mr. **Whittaker**. All right. I'll clarify that for you.

Senator **Symms**. We'll look into that. Thank you very much.

We now have completed our hearing this morning except for the part that I call open mike. I know there's one or two people out in the audience that wanted to make a brief comment or two. So would those come up and please identify yourself for the benefit of our reporter; and then if you would also write your name and address on one of these little pads.

Are there any others that want to come up—Gary—and have a seat?

Mr. **Andersen**. I'd like to come up.

Senator **Symms**. And we'll try to do—I hope you can all be—make your point as directly and concisely as possible. We want to hear from you, but we also want to be able to get on to the next appointment.

So write your name and address. We'll start right there on the end. You can identify yourself for the reporter and then write your name and address, and we'll have it.

STATEMENT OF EDWIN FEND

Mr. **Fend**. Ed Fend, Idaho Falls. And I'm a retired naval officer, but more particularly right now I'm a volunteer—I'm a volunteer in a VITA Program, and I'm a tax aide to the elderly locally here.

Senator **Symms**. What is VITA?

Mr. **Fend**. It's a—VITA Program is a volunteer association under the ARPA system.

My major concern and one that comes up periodically, not periodically, regularly when I do the elderly's taxes is that we're taxing the savings of people over 65. Now, this is something that's been totally left out of every tax bill I've seen, but it's the most repressive tax that I can think of. These——

Senator **Symms**. That's a good idea. In other words, repeal the taxation of——

Mr. **Fend**. Savings.

Senator **Symms** [continuing]. Savings of people over 65?

Mr. **Fend**. Over 65.

Senator **Symms**. Get that passed through the Tax Code and just start lowering it 5 years at a time.

Mr. **Fend**. Absolutely.

Senator **Symms**. That's what ought to be done for the whole country. That's what needs to be done. We ought to stop taxing people on their savings.

Mr. **Fend**. That's right.

Senator **Symms**. And then they'll save more money.

Mr. **Fend**. But I think we've got to start at the top end because these people who have worked within the system, the Social Security system, which we're celebrating the 50th anniversary today—they have worked within the system to lay back money for their old age so that Social Security is a floor or a support package. They're not depending upon Social Security as are many people or many people talk about as total support.

And the funny thing about it is is that we go through—and particularly this administration has been whipped around on the Social Security issue because they propose to cut in the colon.

Now, an interesting thing has come about here. The average Social Security payment—and I could be off—but is around $300 a month if you average the United States. A 3-percent increase in Social Security provides these people with $9 a month. If a person had put away $20,000 in savings and is taxed on it, his tax bill at 14 percent cost him $23 a month.

Now, we're not talking to the old people in the right terms. We have people like Representative Pepper who shakes the drum, rattles the ball, and talks about a $9 increase and never mentions a $23 take-away for these people who have worked within the system.

And I think that we need to look to that problem, publish that problem; and instead of being the whipping boys for Tip O'Neill and his henchmen, go forward with a positive program that means that we can cap some of these uncontrollable spending cuts and still put money in the people's pocket, particularly those people who have worked within the system all their lives and saved enough money to support themselves in their old age.

Senator **Symms**. Ed, thank you very much. You made a very good suggestion in my view. I appreciate it greatly. Next, Grant Packer.

STATEMENT OF GRANT PACKER

Mr. **Packer**. Grant Packer, Idaho Falls, and I have a thought in mind. We've got——

Senator **Symms**. Pull that mike up just a little bit if you would, please, Grant.

Mr. **Packer**. We've got in Idaho Falls between 800 and 900 homes for sale that are listed and probably 1,000 to 1,200 homes that are for sale. We've also—and many of these homes are vacant. We've also got a rental situation that's—that is difficult. People just can't find houses to rent or apartments to rent in this town.

And the other day I wanted to get to the hearing, but I was unable to get there because of another commitment. They're talking about Government subsidized housing of over 300 units in Idaho Falls, rent-subsidized house. Well, that isn't the answer, and it ties in with taxes.

What we—if we can get people, free enterprise, to buy these homes that are on the market and put them on the rental market, the second that they know about those subsidized housing came out in the paper, everybody that was in the market buying a house—I was in the market in the next couple of weeks to buy another couple houses and put them on the rental market. I won't touch them with a 10-foot pole now. I can't because if this other goes through, it will kill me.

I've been trying to accumulate a few rental homes in the last 35 years so that I could take care of my own retirement, which I'm at a point where I can just about do that now. I've, over the years, I've helped some of my renters either buy the house they rent or another house; and I've helped several, several people get into a home of their own.

If they're in a rent-subsidized home, they'll never get in a home of their own. If they're in the free market and somebody approaches them with an idea of buying a home, they'll say: "Hey, you're paying rent, and nobody is helping you pay the rent. But if you buy a home, the Government will help you buy a home because the biggest share of your monthly payment is interest, and it's deductible. And you can go to your employer and sign new W-4 form and come home with another $100 a month that you put on toward buying a home."

And home buyers are better citizens than home renters because they take better care of their property. They keep it up better, and they're accumulating something for themselves and for the Nation. It's a better deal all the way around.

So if we can create a situation that will increase people—people's desire to own a home and ability to own a home, instead of lock them into renting all their lives, we've got a better situation it seems to me like.

Senator Symms. Thank you very much. I appreciate—that's a good point. Gary Robbins.

STATEMENT OF GARY ROBBINS

Mr. Robbins. Gary Robbins, Dietrich, ID. I'm State representative, district 22, over in the other end of the State. I'm also a certified public accountant.

And I'm doing a little project now in the eastern part of the State knocking on a few doors and meeting a lot of people, and a lot of information is being given to me. And being a tax person for about 20 years, I've done tax returns and been involved, that sort of thing.

That is not what's on the people's mind out there. The people out there are concerned primarily about the price of what they have, market price. They're concerned about regulation. They're concerned about the deficit, and not necessarily in that order. I would say probably the deficit is the biggest thing on their mind.

When they talk about taxes, my background is such that I can understand the individual thing on the tax return; and I see it immediately on a tax return, an individual—if they talk investment tax credit, I see it, what it does immediately. The general population does not see those kind of things.

What they do see and what they've known to happen in the past is that anytime there's tax change, it seems like they pay more taxes. That's what they say. Now, that's not necessarily always true, but that's what the people out there think.

So any attempt by Congress and—to restructure taxes does not meet favorably with the people at large. They don't understand, first of all. And all they know is the end result is the budget's larger and larger, and that money has to be coming from them people or borrowed. So it's a concern that they have.

As far as the people—and I've seen many of these people in the last month. They're in sort of a depressed state. I'm primarily in the agricultural area, and they feel like that they have no control over what's going on. They realize that the farm prices, of course, are bad. What they do about the tax system is not going to change that.

But one thing about these people is they realize that this is America, and we have the greatest economic machine there is and that we can get it changed. Some suggestions have been made. Flat tax; there's even talk out there of a national consumer tax, sales tax type thing, something that would be on consumption. There are suggestions coming from these people.

Many people assume that those little people, so to speak, are not knowledgeable out there about things. These people read a lot, and they're ready. They're very ready for something to change.

What we're doing taxwise here is not a change. Well, it's a change, but it's not a simplification certainly. You heard the lady, CPA, talk here. It's absolutely not simplification. It's more work for people like myself if I'm in the tax business. It's more difficult for you people because it's going to be a change that you've almost gotten used to. That's not the answer to our problems.

Senator SYMMS. We had a construction worker and a logger in Coeur d'Alene that testified the other day, and he suggested to throw—he said, "The first thing you need to do is take all the Income Tax Codes and have a big bonfire and burn them up and then put in a national sales tax."

And he was—you know, and there's a guy that says, "I'm a working man." And he was advocating that. And he said, "Then that way nobody can miss it. They all have to pay it."

Mr. ROBBINS. One of the things I found in the State level, tax reform is very, very difficult to achieve. It gores somebody always, and it's very difficult to achieve also because it's so complicated for people to understand.

Same thing is true with this. Senator Symms and the people that sits on his committees, it's difficult for them to understand it all; and there's got to be a simpler method.

Now, as an accountant, that's dumb for me to say because I've made a good living doing tax returns. Fortunately I got out of it, but there are better ways. And it takes people with the knowledge to work toward that.

Senator SYMMS. Do you generally agree, though, we ought to cut the budget?

Mr. ROBBINS. Absolutely.

Senator SYMMS. First?

Mr. ROBBINS. Well, yes, we have to cut, or we have to at least control.

Senator SYMMS. Controlled spending, that's what I mean. When I say "cut the budget," that's what I mean, control spending.

Mr. ROBBINS. Yeah, we have to control spending. See, this creeping thing is even getting in the State of Idaho because we're beginning to index things in the State of Idaho to stay with the Federal. Now, what that does is simply make our budget larger and larger each year same as—Social Security is a good example. The circuit breaker is an example in the State of Idaho.

We're indexing these things, and that's a big problem at the Federal level. Indexing is going to continue to grow whether you spend more or not in programs.

Senator SYMMS. Gary, thank you very much. Appreciate your contribution to this hearing and appreciate—sir, what—you're next up. I'm sorry. I don't know your name—Lloyd Andersen, right.

STATEMENT OF LLOYD O. ANDERSEN

Mr. ANDERSEN. Lloyd O. Andersen, Rigby, ID. I'm a beekeeper in Idaho, and I'm a taxpayer.

Senator SYMMS. How did all the grasshopper spraying affect your bees?

Mr. ANDERSEN. Well, I wasn't in the area, thank goodness. But I'm a very—believer in the Constitution of the United States as George Hansen was. That's why George is not in Congress, because he was a big supporter of the U.S. Constitution.

And I'm maybe—I'm sure Steve won't agree with me, but Willis Stone—I don't know whether you know about him.

Senator SYMMS. Willis Stone is a personal friend of mine. I introduced his bill one time in the House.

Mr. ANDERSEN. Willis Stone was a big supporter of the——

Senator SYMMS. Liberty amendment.

Mr. ANDERSEN [continuing]. Liberty amendment. And I think that we should get back to that Liberty amendment and pass it. That would make the Government sell all the corporations, everything that they're in, which is a violation of the U.S. Constitution anyhow.

And during—you remember back when the Government had synthetic rubber industry? They sold it, and they sold it for I don't know how many million dollars. But anyway, they didn't need it; and if we make the Government sell all these corporations and what they're involved in, we wouldn't need the 16th amendment. We wouldn't need the income tax. We could repeal it. And then another alternative I've got——

Senator SYMMS. I just want to say one thing. I want to correct one thing you said. You said you were sure I wouldn't agree with you. But you were wrong. I sure agree with you.

Mr. ANDERSEN. OK. Thanks, Steve. I really appreciate what you're doing in the Senate.

Senator Symms. We're trying to privatize some of this stuff. You know, it's very interesting. You talk about passing the Liberty amendment. The reason you never hear much about it anymore, the chances of passing that are from slim to zero.

Mr. Andersen. Yeah, I agree with you.

Senator Symms. And we are in a situation where now Mrs. Dole wants to sell Conrail. Now, when Conrail was set up, I was in the House; and the agreement was that the Government was going to take over the Penn Central Railroad and operate it. Once it got to be a viable entity, then they were going to sell it.

And they couldn't make a profit with it until Reagan got elected. When he got elected President, they started getting better work contracts and got it profitable now. Now they're trying to sell it, and one of the big lobbies against selling it are the people that run it, that run it for the Government. It's unbelievable. And, you know, now they've got competition, and it's all bogged down.

And I'd be happy to sell it to anybody, and I didn't dig into it and investigate who ought to buy it or anything. But they thought they had an offer. We ought to sell it and get it privatized, let it out from the thumb of the Government and let it become a taxpayer instead of a tax taker.

Mr. Andersen. That's what the Liberty amendment's all about——

Senator Symms. Right.

Mr. Andersen [continuing]. Is to try to get them to sell it to private industry because private industry can operate cheaper than what the U.S. Government. We've proven that.

Senator Symms. Absolutely.

Mr. Andersen. And then another one here is I'm for the—to pass a flat rate tax across the board, no deductions whatsoever. Everybody pay, well, for instance, example, pay 5 percent. If everybody would pay 5 percent, I think we could run the Government on 5 percent because that would pick up all the tax protesters, and I don't think anybody would object to paying 5 percent tax. And the way it is now, why people are paying anywhere from 50 to 90 percent tax; and that's ridiculous.

And then the next one is to have a sales tax, maybe pass a sales tax in the State and then distribute that back to the Federal Government or government as they need it, which it should be in the States to begin with. I mean it's a violation of the Constitution to be back in Washington to begin with. It was all—when the Founding Fathers set up that, the Constitution, that was all set up for the States, not the Federal Government. And I want to thank you, Steve.

Senator Symms. Well, thank you very much. I appreciate having you up here, and I might just make a comment that back in—is Mr. Stone still alive? Do you know?

Mr. Andersen. I think he died.

Senator Symms. He came back and visited the Congress and a bunch of us one time in the middle seventies. In fact, I got my picture taken with him and with John Rusloe when we had lunch together in the House dining room and talking. And he told me that when he was pushing the Liberty amendment in the 1950's, that most of the income tax revenue was the corporate tax, which he didn't do away with the corporate tax. He did away with individual income tax.

Nowadays it would compound the problem. That's why I say the chances of that are from slim to zero because the Government's program has gotten itself—the demands of Government revenues to spend, to pay the things that they're committed for, only about 20 percent of that comes from corporations now. You know, it's been going down.

Now, this proposal would raise taxes again on corporations, that the President has; and I don't think this proposal is going to pass in its current form. I think maybe it will be—if it does pass, it's going to be a modified form.

But you are right on target in the fact that we are going to continue to have problems in the West. We're going to continue to have problems like right now. In north Idaho I witnessed last week a really traumatic experience to see 137 trucks in Orofino, ID; and, see, these families driving these trucks, in many cases, a guy with his kids and wife in the truck, privately owned trucks, logging trucks, that they don't know what they're going to do.

Potlatch is shut down. It's a logging operation. There's no demands for anybody to haul logs out of the woods, and there is really a problem. It's a town of 4,000 people that have 800 jobs lost in one fell swoop when Potlatch closed the sawmill and plywood operation in Clear Water County.

And I don't see a solution for it in the short term other than some kind of immediate help on border, but the long-term answer is that the timber is out there in the forest. It's just not available to the private enterprise sawmill. You've got a monopoly of the timber in the Government's hands, and these people can't get the timber.

So the rational leader—I mean manager of a company like Potlatch says: "We've got to keep the whole body healthy. We can't afford to keep this thing bleeding us off here and have the whole company go down." And so they start cutting off the things that are losing money, and that's tragic.

And as long as we allow Idaho and other Western States to be run by the socialistic planners in Washington on the Government, on the timber management, or minerals, or whatever it is, we're going to have problems.

Just like the cowboys out here, the price of cattle is going down, not up; and they want to raise the grazing fees. And these guys aren't getting any big bargain out there grazing on this Government land with the price they have to pay and all the loops they have to jump through. And they can't get the range improved, and they can't get the wild horses off the range. And they can't kill the coyotes and one thing on top of another.

But you're right on target. We ought to be marching to the drum beat of privatization; and everything we can do like sewer grants, prisons, all these things, we should be looking at ways to get them out from under the Government so that you can do them cheaper and more efficiently. Thanks very much.

Mr. ANDERSEN. Well, I'm really against subsidies. Now I don't believe in the Government subsidizing everybody. They have this——

Senator Symms. Well, they're subsidizing with somebody else's money. The Government hasn't got anything to subsidize with.

Mr. Andersen. Well, the taxpayers are doing the subsidizing.

Senator Symms. Right, right.

Mr. Andersen. Now, I——

Senator Symms. We've got to break this thing up.

Mr. Andersen. I'm in the bee business; and, of course, they've shipped a lot of honey in this country. They stopped imports except out of Canada. It's in the National Record now, Register, of June 10. They stopped all imports except Canada, and they've just about broke all the beekeepers in the United States.

Senator Symms. Right. We got to have you beekeepers to grow all these seed crops and specialty crops we grow in Idaho.

Mr. Andersen. But, Steve, I really appreciate you sending your mail to me. I haven't answered as I would like to have done, but I enjoy being on this panel. And I want to thank you.

Senator Symms. Thank you very much. We have one last witness here.

STATEMENT OF JoAN WOOD

Ms. Wood. Short, but sweet. I'm Representative JoAn Wood from Rigby, ID. I have District 30 that I represent. And in answer to the letter that I received from your people, Steve, I went to my bookkeeper and went over our business as regards to the proposals made in the President's proposal and the Treasury's proposal and so forth and asked how those would affect our business so that I might testify somewhat in that regard.

To make it short, pretty well what the farming people told you on the panel here today was——

Senator Symms. Do you and your husband—he trucks cattle, too?

Ms. Wood. And raises cattle and has some hay and grain.

Senator Symms. Does he do some trucking also?

Ms. Wood. Yes, he does some trucking also.

Senator Symms. That's what I was thinking.

Ms. Wood. So—in fact, the trucking what's made us a living the last little while. It certainly hasn't been the cattle. We've been adversely affected, as everyone else in that industry has, to the point that we don't make a living at it at all anymore. And of course, the more people going out, the less we'll have to truck. So that doesn't look real promising either, so.

But our bookkeeper has told us—and I will just reinforce what the ag people talked to you about here today. Those were the particular problems in the recordkeeping, increased recordkeeping; and some of that would be a problem and would offset somewhat the lowering of the bracket that we might—but that would be a benefit somewhat to us, the lowering of the bracket.

But he did go through and penciled some of the things; and of course, rather than take those individually now, I'll just say that the President's proposal was—would be better for our own particular case than the Treasury's proposal. And I would say that——

Senator Symms. It would be better than the current law?

Ms. Wood. Somewhat better than the current law. There are some things there that would be a benefit to us.

Senator Symms. The trucking industry, incidentally, is supporting this.

Ms. Wood. The President's proposal?

Senator Symms. Yes.

Ms. Wood. Yes.

Senator Symms. Because they say they're a high tax rate payer, and they want to get other corporations on the same level they are. And so they actually support it. The truckers, the grocery manufacturers, the—some of the food marketing people do it.

If you want to submit those notes for the record, that would be fine, JoAn.

Ms. Wood. Well, I don't think there's anything here other to add particularly other than what these people on the panel—as I came in, I listened to them. They pretty well did cover my testimony, but I thought maybe it would be well to just reinforce what they said and back up what they—the information they gave you because it certainly did cover our case.

Senator Symms. Thank you very much. We appreciate having you. Meeting's adjourned.

[Whereupon, at 12:50 p.m., the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

Western Fidelity Life & Accident Company
1520 West Washington Street – P.O. Box 9327
Boise, Idaho 83707
(208) 385-9011

August 8, 1985

Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Buildings
Washington, D.C. 20510

Attention: Senator Steve Symms

Dear Senator:

In response to your query regarding the tax reform proposal, I would like to make the following observations:

a) I believe the limit on interest deduction is counterproductive to capital expansion and growth in business. I most particularly feel that this hurts Idaho because we have to depend on small entrepreneural type of business for our expansion and financial base.

b) The proposed non-deductibility of interest on a second home is particularly destructive to the resort real estate industry in Idaho. Again, as a small state, this would have a profound negative influence on our resort and tourist potential.

c) The proposed taxation on fringe benefits to employees, in particular group life and medical insurance, is anything but fair to those struggling in the lower reaches of the middle income range. I believe this would profoundly affect the health care services for the working class individual.

d) The proposed taxation of cash values on life insurance policies is an additional burden that will mainly be shared by those of moderate means. This shelter of cash values has encouraged and allowed people to accumulate savings on a systematic monthly basis, even in small amounts. It would seem in a society where we are trying to encourage self-sufficiency and thrift that to steal the opportunity of sheltered growth for the moderate income individual is a cruel dichotomy.

e) Steve, I encourage a fairness in the individual income tax brackets, but changing the game in relationship to entrepreneural expansion and the shelters of moderate income people would have to be counterproductive to all citizens, and most particularly to us in a state where our economy is already staggered by adverse mineral prices, foreign timber subsidies and the general degradation of our agricultural industries. Those few wealthy individuals will find these tax reforms to be in their benefit because they are in a position to seek and find tax shelters that is far beyond an average person's capabilities. Further, paying taxes on their fringe benefits certainly has a less profound effect on a person making $100,000 + per year than it does for a person making $18,000 - $20,000, which is where most of our Idaho residents find themselves.

I encourage you to rethink and assert yourself in a manner that will find equality in individual taxation without preying on the limited advantages offered to moderate income Idaho residents.

Thank you very much for your interest and I will look forward to being at your hearing in Boise on August 12.

Sincerely,

Dick D Drashner

Dick D. Drashner, C.L.U.
President

DDD:lm

AUG 12 REC'D

SKINNER, FAWCETT & MAUK
ATTORNEYS AT LAW

RICHARD A. SKINNER
CHARLES W. FAWCETT
WILLIAM L. MAUK
W. CRAIG JAMES
ALAN C. HERZFELD
ROBERT J. WILLIAMS

515 SOUTH 6TH STREET
POST OFFICE BOX 700
BOISE, IDAHO 83701
TELEPHONE (208) 345-2654

August 9, 1985

The Honorable Steve Symms
P.O. Box 1190
304 N. 8th Street, Suite 338
Boise, Idaho 83701-1190

Re: Effects of Tax Reform on Economic Development.

Dear Senator Symms:

I am writing after receiving your notice of hearings and request for written testimony on the effect of tax reform on the Idaho economy in your capacity as member of the Senate Finance Committee and Joint Economic Committee.

As you know, the tax reform proposal would eliminate the authority for the issuance of tax-exempt small issue industrial development bonds. In the discussion of these provisions it appears that many have assumed that small issue industrial development bonds would be eliminated and that their demise would be "traded" for the preservation of other sections of the Internal Revenue Code or other tax-exempt bonding authority that otherwise might be eliminated.

It has been our experience that the issuance of industrial development bonds has been a major vehicle for economic development in the cities and counties of Idaho.

As you may know, cities and counties in Idaho have had the authority to issue such bonds for approximately two years under a statute allowing financing of manufacturing, processing, assembly, warehousing, solid waste disposal and energy facilities (except electrical energy) and ski areas. During this time Idaho has shown care in selection of projects for financing without the abuses which have caused the increasing federal limitations on these bonds in the past five years.

Senator Symms
Page two
August 9, 1985

Some of the projects we have seen financed in the past two years include the following:

1. Rehabilitation of an abandoned trailer manufacturing facility into a new lumber remanufacturing facility providing jobs for 3C persons in Weiser, Idaho.

2. Rehabilitation of a closed and bankrupt wood products manufacturing facility in Boise, Idaho, which will provide jobs for 40 persons in Boise, Idaho.

3. The rehabilitation and reorganization of a financially failing wood products manufacturing facility near Nampa, Idaho, resulting in the preservation of over 200 jobs in the Canyon County area.

4. The expansion of an onion packing facility to add a freeze processing plant that will add 28 jobs in the Weiser area.

5. Expansion of a potato packing facility in a new location creating an additional 10 jobs near Twin Falls, Idaho.

6. Replacement of an aged wholesale products warehouse in the City of Twin Falls which will allow a doubling of capacity and of employment at the facility.

All of these projects were made feasible due to the lower rates provided by tax-exempt financing without the need for any bureaucratic agency to administer the "subsidy" provided by the tax exemption. Each project will substantially increase the real estate tax rolls of the community and the payroll generated by the facilities will supplement the income tax revenues of the state and the federal government to a far greater extent than any revenue lost due to the exemption of interest on the tax exempt bonds.

The best way to deal with any alleged abuses or alleged over use of small issue industrial development bonds (which we have not seen occur in Idaho) is to impose a volume limitation on the amount of industrial development bonds which can be

Senator Symms
Page three
August 9, 1985

issued by any state and let the state and local communities decide which projects are most likely to really promote economic development in their communities and deserve financing. This was done last year by Congress and the system is working. If there is further desire to limit the issuance of industrial development bonds the volume limit can be raised or lowered by Congress in addition to the many limitations which have already been imposed on this source of financing for economic development.

I hope this information will be helpful to you in your analysis of tax reform. If you have any questions, please do not hesitate to call.

Very truly yours,

SKINNER, FAWCETT & MAUK

RICHARD A. SKINNER

/dg

TREBAR, INC.
P.O. BOX 9207
BOISE, IDAHO 83707 3207
(208) 345-6410
TWX 910-970-5733

August 12, 1985

Mr. Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Buildings
Washington DC 20510

Dear Mr. Cobb,

In response to Senator Symms' request for input on the President's tax reform plan and how it effects our business, the following is submitted for his consideration and/or information:

1. There would be no negative direct effect on our business as long as some form of accelerated cost recovery (depreciation) is maintained. With some modification, particularly shorter life for automotive equipment, the proposal would be acceptable. Indirectly, the loss of the investment tax credit could impact our customers' plans for future vehicle replacements/purchases. However, the Trucking Industry has experienced such devastating losses in past years, that loss of this tax benefit would not be that disruptive.

2. The so-called "windfall profits" tax is unfair and unnecessary, particularly in our business. This is a retroactive tax that would severely impact our business and be extremely difficult for the government to fairly administer.

3. Although the limit on entertainment expenses would be some what restrictive, we could live with it, even though there are better ways to increase revenues by eliminating so-called loopholes. An example would be changing the Lifo method of inventory costing to a method based on inflationary or deflationary indexes. Such a method would be much more relistic, fair, and acceptable. In this vein, it is difficult for us to accept the plans' discrimination in favor of the oil and gas industry. This should be given Steve's personal attention

TREBAR TRUCK CENTER
3939 S. TRANSPORT ST
BOISE, IDAHO 83705

TREBAR KENWORTH SALES
4100 S. TRANSPORT ST
BOISE, IDAHO 83705
300 SOUTH ROAD
JEROME, IDAHO 83338
14TH AND ELGIN
CALDWELL, IDAHO 83605

TREBAR LEASING
3940 S. TRANSPORT ST
BOISE, IDAHO 83705

as it does directly and indirectly affect all other industries and individual taxpayers.

On a personal note, I'd like to express my opinions regarding the deductibility of state and local taxes and interest on mortgages and investments. Interest and taxes on a taxpayer's primary residence should be totally deductible, and the $10,000 limit on investment interest should be retained. A taxpayer should not be allowed to deduct state income or sale taxes, property taxes on secondary dwellings/residences, or interest on those dwellings/residences in excess of an amount prorated according to actual use.

Fundamentally and fiscally the President's plan is sound and acceptable, but requiring some very obvious adjustments and/or modifications. It is impossible to please everyone and if Congress attempts to do so, this could be an opportunity lost forever.

Sincerely,

S. Hatch Barrett
President

SHB:mag
pc: Senator McClure
Congressman Craig
Congressman Stallings

MICHAEL R. JONES
1661 Shoreline Drive Suite 200
P.O. Box 7743
Boise, Idaho 83707
Phone 208 345-6637

ATTORNEY AT LAW
IDAHO
WASHINGTON

CERTIFIED PUBLIC
ACCOUNTANT
IDAHO

August 9, 1985

Mr. Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Building
Washington, D.C. 20510

Subject: Senator Symms Tax Reform Information Request

Dear Mr. Cobb:

Being both a C.P.A. and taxpaying citizen I have a special interest in any new tax reform legislation. I desire tax reform which is simple and fair. I approve of all efforts which attempt to achieve this delicate balance. As an associate member of the Associated General Contractors (AGC) and through my association with various members of the construction industry I am opposed to any changes which might be contemplated in the use of the per centage of completion method of accounting for tax purposes.

Accountants are taught and hopefully they remember the principle of matching revenue and expired costs to determine periodic net income. The problem associated with this matching principle is at what point in time does one recognize revenue.

There are several accepted points. The point of sale, such as when one buys a commodity, say a television. At the point of sale the customer and seller have agreed upon the price, title to the television exhchanges and the seller has a claim of right to payment. Another method of revenue recognition is the receipt of payment or the cash method. This method recognizes revenues when actually or constructively received such as the time you pay your doctor or dentist. Still another method is the installment method which is illustrated by a home seller. The installment method recognizes that each periodic payment is a partial return of capital and gross profit.

Contractors engaged in large construction projects may devote several years to the completion of a particular contract. In order to illustrate a situation of this nature, assume that a contractor engages in a project that will require two years to complete, for which he is to receive $20,000,000. Assume that the total cost to be incurred, which will be spread over the two year period is estimated to be $19,000,000. According to the point of sale criterion, neither the revenue or related costs would be recognized until the project is completed with the result that the entire net income will be reported in a single year. Under the receipt of payment method each payment less actual costs paid will result in net income during the period in which the payment is received.

Whenever the total cost of a long-term contract and the extent of progress can be reasonably estimated, it is preferable to consider the revenue as being earned over the entire duration of the contract. The estimated per-centage of completion can be prepared by comparing incurred costs with the most recent estimates of total costs or by estimates by engineers, architects or other qualified personnel.

Continuing our illustration, assume that at the close of the first year of the contract the contract is estimated to be one-third complete The amount of revenue recognized for the year would be one-third of $20,000,000, or $6,600,000. The actual of costs incurred during the year are then matched against the revenue recognized to end with a net profit.

Currently it is common in the construction industry to use unbalanced bids, i.e. to estimate greater costs in the bid for work activites to be performed and constructed at the start of a contract. Contractors do this to obtain additional funds for operating capital and thus decrease the amount of investment in a project. This early increase in working capital and cash flow assists the contractor in ordering materials, equipment and lease committments and thereby achieving certain economies and purchase discounts. Which in a competitive industry means that the owner or client obtains a fair price and the contractor might make a reasonable profit.

Should a change occur in the per-cent completed method to the receipts or point of sale method then these monies would be unavailable to the contractor for these purposes. In short the tax impact and cash flow decrease would increase the cost of construction. Contractors would spend money ordinarily utilized for leasing, or purchase of materials and equipment, for payments to the IRS or to their banks as interest charges. The undisputed impact would be increased construction costs for both the private and public sectors of our economy. The net result could well be a blunder which will only increase our prolific deficits and increase our overall tax burden for all Americans.

Thus I am opposed to any proposed changes in the per centage of completion method of tax accounting for members of the construction industry.

Very Truly Yours,

Michael R. Jones
Attorney at Law, C.P.A.

cc Idaho Branch of AGC

10763 Mohawk Dr.
Boise, ID 83709
August 9, 1985

Mr. Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Buildings
Washington, D.C. 20510

Dear Mr. Cobb:

I recently received a notice from Senator Symms regarding tax reform and the hearings he plans to hold about this subject in Idaho. I have many opnions about what our tax dollars should be applied to, and what the effect of these expenditures is. Some of these are personal self-interest; some are not. However, we had better get our deficit under control, because we cannot afford the finance charges which will surely lead to a totally bankrupt economy. It seems to me that everyone, the rich, the middle class, and the poor, will be hurt the longer we put off coming to terms with our desire to have more than we can afford, and our selfish desire to have someone else give up his deduction or pay higher taxes for our benefits.

It is my strong belief that we must decrease government costs before any tax reform will be meaningful. To discuss these costs and taxes as two separate entities is, in my opinion, truly naive, as they are intimately related. Since it appears to be impossible to reach a political concensus of priorities, I would suggest that all programs take a proportional decrease to bring the budget into balance. To provide tax revenue to pay for these programs, it is my opinion that a somewhat modified "flat rate" tax, such as President Reagan's, would be the most fair to all. This would result in people trying to make money, and not expending great effort and investments in avoiding taxes, all of which are counter-productive. It should be noted that all deductions are, in effect, a not so subtle attempt to encourage certain types of investment and the resulting activities. I have very little faith in the ability of any governmental entity to choose the most beneficial investments for our society.

In summary, there is no "Santa Claus", and if we do not all suffer some, by controlling our propensity to continue deficit spending, our legacy to future generations will be the debt burden we leave them in place of the shining future left for us. So, let's get on with it!!

Sincerely,

George M. Lostra

GML:kc

BOISE STATE UNIVERSITY • 1910 UNIVERSITY DRIVE • BOISE, IDAHO 83725

DEPARTMENT OF ACCOUNTING
COLLEGE OF BUSINESS
(208) 385-3461

3 August 1985

Mr. Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Buildings
Washington, D.C. 20501

Dear Mr. Cobb:

I have just received the Hearing Notice on the administration's tax reform proposals sent out by my Senator, Steve Symms. My only comment on these proposals is that they like all the other tax bills that have been passed in the 1970's & 1980's have made tax planning impossible. Yesterday, I had to advise the Director of BSU's Idaho Business Development Center that I could not give any opinion as to the tax consequences of a particular business proposal because its operations would not commence until mid-1986 or perhaps 1987 at the earliest. Given the extent of the tax reform proposals before Congress, any project which critically depends on its tax effects in order to be attractive to investors cannot be effectively marketed until Congress imparts greater certainty into the tax code.

Earlier this year another faculty member and I had the opportunity to respond to a letter from a noted local accountant, Bill Tonken, sent to the Idaho legislature which recommended that Idaho's tax rate structure be revised to compensate for the regressivity of the income tax burden bourn by Idaho's citizens as a result of the deductibility of state and local taxes for federal income tax purposes. A copy of our analysis is enclosed. I recommend that the federal income tax deduction for state and local taxes be eliminated in order to produce a more equitable distribution of taxation across income classes. I also think that this particular itemized deduction results in an unjustified federal subsidy to the state of New York in particular.

If I can be of any further assistance to yourself or Senator Symms please call on me. A copy of my faculty data sheet is enclosed. You will note that I have particular expertise in tax accounting.

Sincerely,

Herbert L Jensen

Herbert L. Jensen
Professor

Equal Opportunity/Affirmative Action Institution

Steve -
Sorry I can't attend hearings
you might be interested in my
letter to the President on the subject
Rex Dorman

Rex L. Dorman
P.O. Box 50
Boise, Idaho 83728

June 28, 1985

The President
The White House
Washington, DC 20500

Dear Mr. President:

I recently received a form letter signed by you which begins, "I am deeply grateful to you for your confidence in me and for your support of my re-election as your President." In the past, my wife and I have both been strong supporters of you and the Republican party. We have both contributed financially to your campaigns. However, today we feel betrayed by that support, and frustrated and disturbed by the 180-degree reversal of your position on tax policy.

Your current tax proposal significantly increases taxes on business at a time when increasing foreign competition is threatening the very existence of many of our basic industries. At a time when American business needs the help and support of its government, your proposal eliminates many of the beneficial features of your previous tax bills and makes it far more difficult to invest capital effectively to improve productivity and create jobs in America.

While it is true that your proposal reduces the tax rate on corporations, the proposed changes in depreciation and investment tax credit rules far more than offset the rate reduction, resulting in significantly higher taxes. This in turn must result in lower investment rates and a lower economic growth rate for the country.

The timber industry in the Northwest has been particularly hard-hit by competition from Canada. The elimination of timber capital gains (Section 631-A) along with other proposed changes will force many more companies to go out of business. At the same time that you are gutting the U.S. forest products industry, the Canadian government is being very supportive by selling timber below current market value to Canadian competitors.

As for individuals, your proposal will decrease the tax bill for the very rich, like yourself, and the poor. Most middle-class Americans will pay more in taxes.

Your proposal will cause, and has already caused, significant and painful distortions to long-term financial arrangements of many middle-class Americans. Real estate has dropped significantly in value due to proposed provisions of your tax bill. Worse yet, there is no market for real estate unless it is a primary residence.

I have been contributing a significant portion of my income to a company-sponsored savings plan. Now, after 20 years of planning, you are proposing to change the tax treatment of my savings when I retire and take them out of the plan. I would expect this kind of lack of sensitivity from a Russian leader, but not from an American president.

You are telling us that your proposal is tax simplification. Obviously you have little understanding of the accounting and accounting systems problems your proposal creates. You may take some business away from H&R Block, but your proposal is far more complex than our present system.

Currently, almost all business expenditures are tax-deductible. Therefore, you can use one set of books and records for financial reporting and for tax purposes. The few areas of difference, such as depreciation, non-taxable interest, etc., can be adjusted easily to arrive at taxable income. However, think for a moment about what it will take to figure out how much must be added back to taxable income for the non-deductible portion of business meals over $25. I am a CPA responsible for the accounting records of a company with over 20,000 employees. I can tell you that there is no simple way to gather this information. We will have to spend hundreds of thousands of dollars to revise our computer systems just to account for this one item in your proposal. The cost in terms of tax-deductible expenses to account for this item will forever exceed any political or economic benefit from the change in tax law.

Your proposed tax indexing of depreciable assets will require a totally new asset accounting system that will be many times more complex than the one we are using today. It is difficult to even estimate the expense involved in new computer systems to handle the proposed changes.

There are many other provisions in your tax proposal that will have a very negative effect on individuals and on the economy. I will mention only a few:

- taxation of employer-provided health benefits -- one of the few efficient systems left in the economy; and the government now wants to tax it.

- taxation of cash value increase of life insurance -- one of the truly effective ways to provide for retirement. Now you want to make us pay tax on income that we will not receive for years. Where do you expect us to get the money to pay the tax? We will have to borrow it, and you are proposing to eliminate the deduction of interest expense.

- elimination of the deduction for state and local taxes -- this simply increases the impact of these taxes on individuals and will put pressure on all local governments at a time when many are in serious trouble.

Your support of this tax bill will go down in history as one of the major mistakes of your presidency. You have diverted attention from the major issue, which is excessive government spending. You were given a mandate by the people to cut spending and reduce the deficit and you have allowed the Democrats to shift the attention to tax reform. By your support of the tax bill you have split your supporters and business leaders. Many like myself are no longer going to support you.

It is not too late for you to provide leadership to the country and the Republican party. However, you must abandon "tax reform" and attack excessive government spending, which is the real issue facing us.

Very truly yours,

Rex L. Dorman

RLD/mp

CORBETT, RANDS & TARTER

WILLIAM C. CORBETT, C.P.A
L. DAVID RANDS, C.P.A
JERRY L. TARTER, L.P.A

LICENSED PUBLIC ACCOUNTANTS

August 7, 1985

Honorable Herb Carlson
1812 Hill Road
Eagle, Idaho 83616

RE: Joint Economic Committee Hearing

Dear Herb:

I Have enclosed some ideas regarding the proposed tax law changes. Hopefully these hearings will provide the needed input to modify this proposal.

Thank you for the opportunity to express my views.

Sincerely,

Jerry L. Tarter

Jerry L. Tarter, L.P.A.

200 NO. 23rd STREET • P.O. BOX 2603 • BOISE, IDAHO 83701 • (208) 342-2667

4.05 - Repeal of income averaging -

No. This is a definite benefit to individuals whose income fluctuates dramatically or who have a one time large gain. Income averaging should remain.

4.06 - Simplify penalty provisions -

a) Yes.

b) No. Penalties should have a maximum limit. Taxpayers may have a tax change due to an audit and could result in a penalty. An upper limit would prevent the IRS from financially destroying the taxpayer.

c) Yes. With one exception. If a taxpayer is on a payment schedule, no cost of collection charges are to be assessed.

5.01 - Non-filing system -

No. This type system has the potential of turning the country into a dictatorship. The government would have too much control over individuals.

7.01 - Capitol cost recovery -

No. You previously stated the tax system is too complex. At the present time there are more depreciation and cost recovery rules than anyone can effectively administer. Why not let the cost recovery system remain unchanged.

7.02 - Investment tax credit -

No. This could be a real deterrent to business and industry for expansion. At the present time, investment credits are a large incentive for businesses to make capital expenditures and expand facilities. If repealed, this could have a definite impact on the economy.

7.03 - Treatment of capital gains -

No. Leave the current 60% exclusion in effect. I believe this ia a good incentive for individuals to make capital investments and stimulate the economy.

8.03 - Limit use of cash method of accounting -

No. Many small businesses are effectively operated on the cash basis of accounting and the owners lack the technical knowledge to implement the accrual method.

8.04 - Reserve method of bad debt deduction -

No. Taxpayers should be allowed the reserve method of deducting bad debts. This method properly matches the income and expenses for accrual basis taxpayers.

13.02 - At-risk limitations to real estate -

No. If the at-risk limitations are applied to real estate, the rental housing market will be destroyed. There would be absolutely no incentive for a landlord to own property if they could not deduct the losses. If we didn't have landlords and rental property, where would all of these people live that can't afford to buy their own home?

13.03 - Alternative minimum tax for noncorporate taxpayers.

Why revise the rules? This additional tax is assessed to the individuals with " tax preference " items at this time. If anything is done, abolish the alternative minimum tax.

14.01 - IRA contributions -

Yes. The only addition would be to raise the limit from $2,000.00 to $3,000.00 each.

14.02 - b) Repeal of ten year averaging on lump sum distributions

No. This ten year averaging is extremely beneficial upon termination of the plan or if the employee is terminated.

14.03 - Tax favored retirment plans -

All of the proposed taxes for retirement plans should be eliminated. If the taxes were imposed, the incentive for retirement would be eliminated. The current social security system is overburdened and people solely dependent on social security are having a difficult time financially. Everyone needs the tax advantage of funding their own retirment. Let the employers assist their employees in funding their retirment.

STATEMENT

on behalf of the

IDAHO HOUSING AGENCY

regarding

THE IMPACT OF THE PRESIDENT'S TAX REFORM PROPOSALS ON HOUSING AFFORDABILITY IN IDAHO

before the

U.S. SENATE JOINT ECONOMIC COMMITTEE

The Idaho Housing Agency (IHA) was created by the Idaho State Legislature in 1972 to provide adequate housing for low- and moderate-income Idahoans. We have been successful in fulfilling this legislative mandate for over 17,000 Idaho households or approximately 48,000 citizens.

We appreciate the opportunity to comment on the President's Tax Proposals to the Congress for Fairness, Growth and Simplicity and its effect on housing affordability in Idaho.

Numerous studies* have indicated that housing costs will increase for both homeowners and renters as the result of the tax changes being proposed. In Idaho, with a per capita income ($9,259) 16% below the national average ($11,056), this increase in housing costs will be particularly burdensome. Presently 71.6% of the households in Idaho cannot afford an average priced home ($58,100), and 41.6% of the renter households pay over 35% of their income for rent.

Compounding the existing housing affordability problem in Idaho is a basic shift taking place in the employment base. Employment in the traditional and higher paying industries of mining, lumbering, agriculture, construction and food processing is decreasing while employment in the service industries is increasing. While employment opportunities exist in Idaho, they are in lower paying occupations. There has been a basic wage structure shift in available jobs downward from annual salaries of $17,000 - $20,000 to annual salaries of $10,000 - $14,000. This basic shift of employment means that median household income will probably be declining, even as housing costs are increasing. A greater percentage of the population will not be able to buy a home and renters will have even less discretionary income as they will be forced to pay a greater percentage of income for rent.

---

* 1) Assessment of the Likely Impacts of the President's Tax Proposals on Rental Housing Markets"
William Apgar and James Brown, Harvard University
Arthur David and George Schink, Wharton Economitric Foreclosing Associates.

2) "Impacts of the President's Tax Proposal on Housing," National Association of Homebuilders, Robert Findlay

3) "Impacts of the President's Tax Proposals on Real Estate and Real Estate Investment", NAR®

The housing affordability problem in Idaho is formidable under current conditions but will become ciritcal with the passage of the tax reform plan as now proposed. The tax savings under the proposed plan, to low- and moderate-income households, will not even begin to compensate for the increase in rents and after tax homeownership costs that will result.

A further problem with the President's tax reform proposal is the elimination of private purpose bonds, which includes tax-exempt mortgage revenue bonds (MRBs).

MRBs have been the main instrument available to the Agency for making housing more affordable in Idaho. The Agency uses the proceeds of these bond sales to provide single family and home improvement loans and to finance apartment construction for low- and moderate-income households. The use of tax-exempt financing allows homeowners to access the mortgage credit market at 2-4% below the conventional rate and decreases total apartment financing costs, thereby lowering rents.

Tax-exempt mortgage revenue bonds have been responsible for importing $445 million into Idaho, a state which generally does not have surpluses of capital for lending. The catalytic force of this new capital has produced 9,000 single family loans, 1,000 home improvement loans and 2,100 units of new apartment development. In addition it has spurred economic activity in the state that has generated 25,000 new jobs, increased state tax revenues by $24 million, increased federal tax revenues by $25 million, and increased Idaho personal income by $378 million.

Tax-exempt mortgage revenue bonds (MRBs) have both an economic and social benefit to the State of Idaho, beyond importing needed capital and generating the economic activity. MRBs allow a larger percentage of Idaho's population to become homeowners and thereby allow people to become stockholders in their community and allow them to take the first step toward active participation in the free enterprise system. In addition, the largest investors in MRBs are private citizens; this encourages savings, increases capital for mortgage investment and continues to involve ordinary citizens in the saving and investing cycle.

The deregulation of federal banking laws and the strengthening of the national secondary mortgage market has increased the number of sources for mortgage capital. However, the reverse side of the issue is that Idaho households now compete for mortgage funds with the federal government, large corporations and states where household incomes are substantially higher. Presently, the use of MRBs provides some insulation for low- and moderate-income Idaho households against the rising cost of competing for mortgage capital. Eliminating MRBs will remove the only safeguard for the availability of affordable mortgage funds in Idaho.

MRBs are already highly regulated and restricted. The uses of MRB proceeds are targeted to limited income homebuyers. The elimination of MRBs along with the 10 other changes below that impact housing would leave low- and moderate-income homebuyers and and renters extremely vulnerable to rising housing costs:

(1) Elimination of the deduction for state and local taxes.
(2) Limitation of non-business and non-primary residence home mortgage interest deductions.
(3) Establishment of a less favorable depreciation system, providing a 28-year recovery period for buildings.
(4) Taxation of profits on the sales of buildings at ordinary income rates.
(5) Repeal of rapid write-offs for rehabilitation of low-income housing units.
(6) Repeal of 10-year amortization for construction period interest and taxes.
(7) Repeal of tax credits for the rehabilitation of historic structures.
(8) Restrictions on the deductibility of limited partners' interest expenses.
(9) Extension of the at-risk rules to real estate activities.
(10) "Windfall" depreciation recapture.

There may be means of providing affordable mortgage financing to low- and moderate-income households, other than through the use of MRBs. The U.S. Senate originated the idea of using mortgage credit certificates in the 1984 tax bill and now, even prior to final rules being promulgated for that program, it also is eliminated in the President's tax plan. It seems ill-advised to remove MRBs, a broadly used and successful housing program, without any alternative being propsed. While the Administration has a policy for tax reform, foreign affairs and national defense, it sadly lacks even a rudimentry policy for housing.

We want to stress the point that reliable access to affordable financing is the underpinning to a healthy housing industry. With federal budget deficits continuing at unprecedented levels, the inevitable competition between federal and private borrowing will maintain high real interest rates and will threaten the availability of mortgage capital. Lower interest rates which can result from sensible monetary and fiscal policies should be the highest priority for elected officials of a state which relies so heavily on a vibrant housing industry. Considering a tax proposal which may increase federal budget deficits by $53.3 billion by 1990, seems unreasonable.

Enclosed as Attachment A is a study performed by the Agency showing the increase in the number of Idaho households able to purchase homes and the increase in economic activity in the State of Idaho when the below market interest rate financing of MRBs is available.

ATTACHMENT A

Increase in Number of *Households Able to Purchase Homes and the Increase in Economic Activity in the State of Idaho When Below Market Interest Rate Financing is Available

---

*The households listed represent those currently renting and paying monthly rental payments comparable to the principal and interest payment that would be due on a home purchase.

INTRODUCTION

The current conventional interest rate for home mortgage loans in Idaho is 12 1/2%. Present market analysis information has identified 4,000 households as able to purchase homes at the conventional 12 1/2% interest rate. These households are now renting and paying a rental amount comparable to the monthly principal and interest due on a $40,000 home.

With no home mortgage financing available at below the conventional market, **11,000 households are eliminated from the homebuying market in Idaho**.

Home financing available through Tax Exempt Mortgage Revenue Bond (MRB) programs have historically offered an interest rate 2-4% below market rates to income-qualified homebuyers. This type of financing increases the homebuying market considerably and has a positive economic impact on the state.

The following study shows the increase in number of households able to purchase homes when mortgage interest rates are available at 2-4% below the current market rate and the accompanying increase in economic activity within the state.

Interest Rate at 2% Below Market (10 1/2%)

Purchase Price of Home	Increase in Households Able to Purchase
$65,000	1,100
50,000	3,000
40,000	3,400

Purchase Price	P/I* @ 12 1/2%	Annual Income Necessary	P/I @ 10 1/2%	Annual Income Necessary	Monthly/ Yearly Savings
$65,000	694	$34,700	595	$29,750	$ 99/1188
50,000	534	26,700	457	22,850	77/924
40,000	427	21,350	366	13,300	61/732

Increased Economic Impact to State

Based on 40% new construction/60% Sale of Existing Home

Gain in Personal Income	$ 56,900,000
New Construction Dollars	45,600,000
Gain in State Income, Sales & Property Taxes	7,260,000
Gain in Federal Income Tax Revenues	5,500,000
Man years of Employment (jobs) generated	2500

The U.S. Treasury estimated a revenue loss to the Treasury of $40,000 for every 1,000,000 of MRB's sold. The sale of **$113,000,000** in MRB would finance the sale of the homes listed above, resulting in a **$4,500,000** loss to Treasury using their assumption. But the economic activity generated would bring **$5,500,000** to the U.S. Treasury resulting in a **$1,000,000** net gain.

*P/I indicates monthly principal and interest payment.

Interest Rate at 3% Below Market (9 1/2%)

Purchase Price of Home	Increase in Households Able to Purchase
$65,000	1,100
50,000	4,600
40,000	9,200

Purchase Price	P/I @ 12 1/2%	Annual Income Necessary	P/I @ 9 1/2%	Annual Income Necessary	Monthly/ Yearly Savings
$65,000	694	$34,700	547	$27,350	$147/1754
50,000	534	26,700	420	21,000	123/1476
40,000	427	21,350	336	16,800	91/1092

Assumes 50% New Construction 50% Sale of Existing Homes

Gain in Personal Income	$ 148,700,000
New Construction Dollars	106,400,000
Gain in State Income, Sales & Property Taxes	11,804,876
Gain in Federal Income Tax Revenues	11,898,740
Man years of Employment (jobs) generated	6600

The U.S. Treasury estimated a revenue loss to the Treasury of $40,000 for every 1,000,000 of MRB's sold. The sale of $215,000,000 in MRB would finance the sale of the homes listed above, resulting in a $8,600,000 loss to Treasury using their assumption. But the economic activity generated would bring $11,900,000 to the U.S. Treasury resulting in a $3,300,000 net gain.

TESTIMONY ON THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH AND SIMPLICITY

PROVIDED BY:
MICHAEL A. GUERRY
REPRESENTING:
GUERRY, INC.
GUERRY BROS. FARMS
GALLOWAY, GUERRY & CO.
AUGUST 6, 1985

SUBMITTED TO:
THE HONORABLE SENATOR STEVE SYMMS
C/O JOSEPH J. COBB
JOINT ECONOMIC COMMITTEE
SD-G01 SENATE OFFICE BUILDINGS
WASHINGTON, D.C. 20510

AS A WAY OF INTRODUCTION, I AM A SHAREHOLDER AND DIRECTOR OF GUERRY, INC., A RANCHING CORPORATION, RUNNING SHEEP AND CATTLE, A PARTNER AND MANAGER OF GUERRY BROS. FARMS, A ROW CROP FARMING PARTNERSHIP, FARMING THREE HUNDRED AND TWENTY (320) ACRES OF GRAVITY IRRIGATED FARM LAND, AND A CERTIFIED PUBLIC ACCOUNTANT AND PARTNER IN GALLOWAY, GUERRY & CO. A CPA FIRM WITH THE MAJORITY OF ITS CLIENTS BEING IN THE FARMING AND RANCHING INDUSTRY.I AM ALSO, VICE-PRESIDENT OF THE "71" LIVESTOCK ASSOCIATION, A GRAZING ASSOCIATION IN THE THREE CREEK AREA ON THE IDAHO-NEVADA BORDER, A MEMBER OF THE BOARD OF DIRECTORS OF THE MAGIC VALLEY CATTLEMEN'S ASSOCIATION AND A MEMBER OF THE FARMING AND RANCHING COMMITTEE WITH THE IDAHO SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS. I LIVE IN CASTLEFORD, IDAHO, WHICH IS LOCATED APPROXIMATELY THIRTY (30) MILES SOUTHWEST OF TWIN FALLS, AND ALL OF THE ABOVE MENTIONED BUSINESSES ARE HEADQUARTERED THERE ALSO. WITH THE EXCEPTION OF THE YEARS I SPENT AT COLLEGE AND TWO (2) YEARS I SPENT WORKING FOR KAFOURY, ARMSTRONG & CO. A CPA FIRM IN ELKO, NEVADA, PRIOR TO RETURNING TO THE RANCH IN 1980, I HAVE LIVED AND WORKED ON THE FAMILY FARMING AND RANCHING OPERATIONS ALL OF MY LIFE.

AT THE OUTSET I WOULD LIKE TO NOTE THAT I AM ALSO A PROPONANT OF TAX REFORM. AS I FEEL THAT THE TAX SYSTEM HAS BECOME EXTREMELY COMPLEX, THE PAPERWORK REQUIREMENTS VERY CUMBERSOME, AND THAT A DISPROPORTIONATE SHARE OF THE TAX BURDEN IS BEING CARRIED BY PEOPLE IN AND ASSOCIATED WITH AGRICULTURE. I WOULD ALSO LIKE TO NOTE THAT I FEEL IN MANY INSTANCES THE PRESIDENT'S TAX PROPOSAL HAS ADDRESSED THIS SITUATION VERY WELL, ESPECIALLY IN THE AREAS OF ITS EFFORTS TO CREATE A MORE EFFICIENT TAXING SYSTEM AND TO CLOSE MANY OF THE UNPRODUCTIVE LOOPHOLES THAT NOW EXIST. HOWEVER, IT IS MY OPINION THAT WHEN THE PROPOSAL STRAYED FROM THESE AREAS THAT MANY OF THE ADDITIONAL PROPOSED CHANGES WOULD HAVE AN ADVERSE EFFECT ON AGRICULTURE, CAUSING THIS INDUSTRY TO CARRY THE BRUNT OF

THE ADDITIONAL TAX LOAD, AT A TIME WHEN AGRICULTURE IS SUFFERING ONE OF THE WORST RECESSIONS IN RECENT HISTORY AND IS ALREADY CARRYING AN EXCESSIVE TAX LOAD DUE TO THE SHIFTING OF TAXATION TO IT ON THE LOCAL, STATE AND FEDERAL LEVELS IN RECENT YEARS.

IT IS WITH THE AFOREMENTIONED IN MIND THAT I WOULD LIKE TO DISCUSS THE FOLLOWING ADVERSE PROPOSALS IN MORE DETAIL:

I) REDUCTION OF MARGINAL TAX RATES - EFFECTIVE DATE:

WITH THE EFFECTIVE DATE FOR THE REDUCTION OF MARGINAL TAX RATES BEING JULY 1, 1986 AND THE EFFECTIVE DATE OF MANY OF THE PROPOSALS TO REDUCE THE AMOUNT OF DEDUCTIONS AND CREDITS AVAILABLE (SUCH AS, THE CAPITALIZATION OF PREPRODUCTIVE COSTS, THE REDUCTIONS IN THE AMOUNT OF CAPITAL RECOVERY COSTS TO BE RECOVERED IN ANY ONE YEAR AND THE REPEAL OF THE INVESTMENT TAX CREDIT) BEING JANUARY 1, 1986, THIS WOULD COMPOUND GREATLY THE INCREASED TAXATION IN THE FIRST YEAR OF THE PROPOSAL, DUE TO THE FIRST SIX (6) MONTHS OF 1986 BEING COVERED BY THE OLDER AND HIGHER MARGINAL TAX RATES.

THUS, IT IS MY OPINION THAT THE EFFECTIVE DATE OF THE REDUCTION IN MARGINAL TAX RATES (BOTH CORPORATE AND INDIVIDUAL) MUST BE MOVED BACK TO JANUARY 1, 1986 IN KEEPING WITH THE REVENUE NUETRALITY IDEAL OF THE PROPOSAL.

II) REPEAL OF TWO-EARNER DEDUCTION:

IN THE INSTANCE OF YOUNG MARRIED COUPLES TRYING TO GET A START IN AGRICULTURE, OFTEN TIMES, THE SPOUSE WILL BE REQUIRED TO MAINTAIN OFF FARM EMPLOYMENT TO SUPPLEMENT THE FARMS INCOME IN THE BEGINNING YEARS. ALSO, DUE TO LIMITED EMPLOYMENT OPPORTUNITIES IN A FARMING AREA AND OFTEN TIMES LIMITED EDUCATION ON THE PART OF THE SPOUSE THEY ARE ON THE LOW END OF THE PAY SCALE, CAUSING THEIR TAKE HOME PAY TO BE MARGINAL AT BEST.

THUS, WERE IT NOT FOR THE TWO-EARNER DEDUCTION THE TAXATION OF THIS ADDITIONAL INCOME WOULD BE DONE AT A HIGHER MARGINAL TAX RATE, REDUCING SUBSTANTIALLY THE BENEFIT TO THE OPERATION OF THE ADDITIONAL INCOME, AND IN MANY INSTANCES, I FEAR, JEOPARDIZING THE VIABILITY OF THE OPERATION IN ITS EARLY YEARS.

III) REPEAL OF INCOME AVERAGING:

WERE IT NOT FOR INCOME AVERAGING IN THE AGRICULTURAL SECTOR, THEN DUE TO ITS CYCLICAL NATURE, AGRICULTURE WOULD BE FORCED TO PAY TAXES AT A HIGH MARGINAL RATE IN THE OCCASIONAL GOOD YEAR AND IN THE OVERALL PAY MORE IN TAXES THAN A TAXPAYER WITH A CONSISTANT INCOME WHOSE TAXES ARE PAID EACH YEAR AT A LOWER MARGINAL TAX RATE.

THUS, IN ORDER TO MAINTAIN AN EQUITY BETWEEN TAXPAYERS, AND NOT PENALIZE THOSE IN AGRICULTURE, THE INCOME AVERAGING MUST BE

MAINTAINED.

IV) REPEAL OF THE SPECIAL ELECTION TO EXPENSE SOIL AND WATER CONSERVATION EXPENDITURES:

AT A TIME WHEN THIS NATION IS LOSING LARGE AMOUNTS OF ITS TOPSOIL ANNUALLY, IT WOULD APPEAR TO ME TO BE A POOR TIME TO BE LOOKING AT REPEALING THE SPECIAL ELECTION TO EXPENSE SOIL AND WATER CONSERVATION EXPENDITURES. AS DUE TO THE POOR ECONOMY BEING SUFFERED BY AGRICULTURE, IT IS DUE MAINLY TO THIS SPECIAL ELECTION THAT ANY CONSERVATION WORK IS BEING DONE.

THEREFORE, I FEEL THAT THE SPECIAL ELECTION SHOULD BE MAINTAINED IN ORDER THAT CONTINUED EFFORTS MAY BE MADE TO SAVE THIS VALUABLE RESOURCE.

V) ADOPTION OF A NEW CAPITAL COST RECOVERY SYSTEM:

LENGTHENING OUT OF THE RECOVERY PERIOD OVER WHICH THE COST OF AN ASSET MAY BE RECOVERED AND THUSLY, REDUCING THE AMOUNT OF RECOVERY DEDUCTION THAT MAY BE TAKEN IN ANY ONE YEAR, DURING A TIME THAT AN INDUSTRY IS IN A RECESSION AND REQUIRES INCENTIVES TO SPUR INVESTMENT, IS AN EXTREMELY POOR ECONOMIC PRACTICE.

THUS, TO DO THIS TO AGRICULTURE AT THIS TIME WOULD HAVE A VERY DRAMATIC EFFECT. TO DO THIS AT A LATER DATE WHEN THE ECONOMY OF THE AGRICULTURAL INDUSTRIES IS IN A MORE PROSPEROUS POSITION AND NO LONGER REQUIRES THE ADDITIONAL INCENTIVES WOULD BE A MUCH MORE PROPER PROCEDURE.

THUS, AT THIS TIME IT WOULD BE MY OPINION, THAT THE THE CURRENT COST RECOVERY SYSTEM SHOULD REMAIN IN EFFECT.

VI) REPEAL OF THE INVESTMENT TAX CREDIT:

FOR ALL OF THE SAME REASONS LISTED IMMEDIATELY ABOVE, AND ALSO DUE TO THE RAMIFICATIONS THAT WOULD BE FELT BY THE MANUFACTURING INDUSTRIES RELATED TO AGRICULTURE THROUGH REDUCED PURCHASES OF MACHINERY AND IMPROVEMENTS, IT WOULD BE DEVASTATING AT THIS TIME FOR THE INVESTMENT TAX CREDIT TO BE REPEALED.

THUS, IT WOULD BE MY FEELING THAT THE ONLY TYPE REDUCTION THAT COULD BE ALLOWED IN THIS INSTANCE WOULD BE TO ALLOW A TWENTY-FIVE THOUSAND DOLLAR ($25,000.00) CAP ON THE INVESTMENT CREDIT THAT COULD BE CLAIMED BY AN INDIVIDUAL IN ANY GIVEN YEAR, WITH AMOUNTS IN EXCESS OF THAT CAP BEING CARRIED FORWARD TO THE FOLLOWING YEAR.

VII) REVISION OF TAX TREATMENT OF CAPITAL GAINS (SECTION 1231):

ONCE AGAIN DUE TO THE CYCLICAL NATURE OF THE LIVESTOCK MARKETS, ONLY ONCE IN A GREAT WHILE DOES THE SITUATION COME ALONG THAT PRODUCERS GET THE OPPORTUNITY TO RECEIVE ENOUGH OF A PAYMENT ON

DEPRECIABLE TYPE PROPERTY TO RECOVER MORE THAN THE DEPRECIATION TAKEN ON THAT PROPERTY, WHICH IS TAXED AS ORDINARY INCOME, AND TRIGGER A CAPITAL GAIN. ALSO, DUE TO THE CHANGE THAT WAS BROUGHT ABOUT BY THE TAX REFORM ACT OF 1984, ONLY GAINS IN EXCESS OF THE ORDINARY LOSSES TAKEN ON SECTION 1231 PROPERTY IN THE PAST FIVE (5) YEARS, WILL TRIGGER A CAPITAL GAIN.

THEREFORE, I DO NOT BELIEVE THAT THE SITUATION SHOULD BE MADE EVEN HARSHER BY DROPPING ANY POSSIBLITY OF CAPITAL GAIN TREATMENT, AS DUE TO THE RARENESS OF THIS SITUATION AS MENTIONED ABOVE, AND THE DEPRESSED SITUATION THAT THE INDUSTRY IS SUFFERING, I BELIEVE WE SHOULD BE ABLE TO RECEIVE THE CAPITAL GAIN TREATMENT TO HELP, IN ESSENCE AVERAGE THE GAIN.

VIII) REVISION OF ACCOUNTING RULES FOR PRODUCTION COSTS:

REVISION OF ACCOUNTING RULES FOR PREPRODUCTIVE PERIOD COSTS ARE SO FAR FETCHED THAT WERE IT NOT FOR THE CONCERN OVER THE NIGHTMARE ACTUALLY BECOMING LAW, IT WOULD NOT EVEN WARRENT COMMENT. HOWEVER, WITH THIS DRAGON ONCE AGAIN REARING ITS UGLY HEAD, THOSE BEHIND ITS REVIVAL MUST AGAIN BE REMINDED OF THE IMPOSSIBILITY OF ACCOUNTING FOR SUCH A SITUATION IN THE REAL WORLD AND THAT BUSINESS PURPOSE, NOT TAX AVOIDANCE , IS THE UNDERLYING REASON BEHIND THE SITUATION, AS MANY OF THESE TYPE SITUATIONS HAVE TO BE STARTED ONE AND EVEN TWO YEARS AHEAD OF TIME. SUCH AS IN THE INSTANCE OF RAISING HEIFERS OR EWE LAMBS FOR REPLACEMENT PURPOSES.

THEREFORE, THIS TYPE OF PREPRODUCTIVE PERIOD COST ACCOUNTING WOULD BE A TOTALLY UNACCEPTABLE SITUATION, AND IN THE END RESULT WOULD CREATE A WASH ANYWAY, WHILE BRINGING WITH IT ADDITIONAL REEMS OF WORTHLESS PAPERWORK.

IX) REVISION OF ALTERNATIVE MINIMUM TAX ON NONCORPORATE TAXPAYERS AND CORPORATE MINIMUM TAX:

REVISION OF CORPORATE MINIMUM TAXES TO BRING THEM MORE IN LINE WITH THE ALTERNATIVE MINIMUM TAX ON NONCORPORATE TAXPAYERS I FEEL IS PROBABLY A GOOD IDEA. AS IT WOULD HELP TO ELIMINATE SOME OF THE CONFUSION PROVIDED BY TWO FORMS OF MINIMUM TAX. HOWEVER, TO LOWER THE STATUATORY EXCLUSION AVAILABLE AGAINST THE ALTERNATIVE MINIMUM TAX, A TAX WHICH HAS HAD A DEVASTATING EFFECT ON AGRICULTURE DUE TO ITS BEING TRIGGERED BY THE TIMING DIFFERENCES ON SALES BROUGHT ON BY CYCLICAL MARKETS, WOULD BE ONE OF THE LARGEST MISTAKES THAT COULD BE MADE UNDER THIS ACT. SINCE THE MINIMUM TAX ALREADY WORKS AS A DISINSENTIVE TO HOLD OUT FOR HIGHER PRICES BY ITS WORKING AS A PENALTY AGAINST INCREASED SALES ABOVE AND BEYOND THE NORM IN ANY GIVEN YEAR. OBVIOUSLY THIS IS NOT WHAT AN INDUSTRY THAT IS ALREADY SUFFERING FROM A DEPRESSED MARKET SITUATION NEEDS AT THIS TIME.

X) ADJUSTMENT OF TAX RATES ON UNEARNED INCOME OF MINOR CHILDREN AND IMPOSITION OF CURRENT TAXATION ON LIFE INSURANCE INSIDE BUILD-UP:

WITHIN AGRICULTURE THERE IS A SITUATION THAT OFTEN TIMES DEVELOPS WHERE THERE WILL BE A LOT OF REAL WORTH BUILT UP IN A FARMING OR RANCHING OPERATION BUT YET A LIMITED AMOUNT OF CASH FLOW. THIS SITUATION IN MOST INSTANCES HOWEVER DOES NOT CAUSE A PROBLEM UNTIL THE OPERATION FACES AN ESTATE TAX PROBLEM AT THE DEATH OF ONE OF THE PRINCIPAL OWNERS AND THEN THE OPERATION IS PUT IN A FINANCIAL BIND DUE TO THE LARGE ESTATE TAX BILL AND LIMITED RESOURCES WITH WHICH TO PAY IT. IN TOO MANY INSTANCES AT THIS POINT, EITHER PART OR ALL OF THE OPERATION HAS TO BE SOLD TO COME UP WITH THE CASH TO PAY THE TAX BILL, IF NO ESTATE PLANNING HAS BEEN DONE.

THE ABOVE SITUATION IS ONE THAT CAN BE VERY DEVASTATING TO A FAMILY OPERATION WHERE THE PARENTS ARE TRYING TO PASS THE OPERATION ALONG TO THEIR CHILDREN. HOWEVER, THE SITUATION CAN BE RESOLVED OR AT LEAST MINIMIZED THROUGH PROPER ESTATE PLANNING.

UNFORTUNATELY, WITH THE PROPOSALS TO TAX THE INSIDE BUILD-UP OF LIFE INSURANCE AND TO TAX THE UNEARNED INCOME OF MINOR CHILDREN AT THEIR PARENTS HIGHER MARGINAL TAX RATES, TWO OF THE FEW ESTATE TAX PLANNING TOOLS AVAILABLE HAVE HAD THEIR EFFECTIVENESS STRONGLY LIMITED OR EVEN WIPED OUT. AS IS OBVIOUS, TAXING THE INSIDE BUILD-UP OF LIFE INSURANCE LIMITS THE AMOUNT OF LIFE INSURANCE ONE CAN CARRY TO TRY TO COVER THE TAX WHEN THE ESTATE OCCURS, AND TAXING THE MINOR CHILDREN AT THE HIGHER TAX RATE DISALLOWS THE PARENTS ABILITY TO PASS OUT INCOME TO THEM TO HELP IN LESSENING THE OVERALL ESTATE.

THEREFORE, WITH THE UNFAIRNESS THAT IS ALREADY ASSOCIATED WITH ESTATE TAXES I CAN NOT SUPPORT ANY FURTHER LESSENING OF THE TOOLS THAT ARE AVAILABLE FOR USE AGAINST THEM.

IN CLOSING I WOULD LIKE TO NOTE THAT THIS IS A VERY COMPREHENSIVE TAX ACT AND THAT DUE TO THE TIME CONSTRAINTS INVOLVED I HAVE ONLY BEEN ABLE TO SCRATCH THE SURFACE OF ITS EFFECTS. THEREFORE, I WOULD LIKE TO ASK THAT ALL LINES OF COMMUNICATION BE KEPT OPEN IN ORDER THAT WE MIGHT BE ABLE TO HELP CORRECT SOME OF THE PORTIONS OF THE ACT THAT WE FEEL ARE ADVERSE TO OUR SITUATION PRIOR TO ITS IMPLEMENTATION.

SUBMITTED BY:

Michael A. Guerry

MICHAEL A GUERRY

TOM BAKER
CERTIFIED PUBLIC ACCOUNTANT
P. O. BOX 1160
CHALLIS, IDAHO 83226
208-879-4553

Joseph J. Cobb
Joint Economic Committee
SD-601
Washington, D.C. 20510

Re: Mr. Steve Symms and his request to hear from taxpayers on proposed law changes.

I apologize that I have not been able to sit down and thoroughly analyze the effect the proposed law change will have on my clients. I have been keeping an ear to the ground on the changes, but have not had the time to really see what it meant until I received the request from Mr. Symms. My letter will be only in generalities and in light of what I percieve the changes to be.

1) Repeal of Investment Tax Credit, I don't know if anyone has sat down and thought what this would do to the largely agricultural economy of this state. The agricultural sector is in enough trouble now without taking away any of its tax advantages, and there are many tax advantages to being a farmer, and put there to stimulate growth, which is needed now more than ever.

2) As everyone must realize the tax revenues collected by our government must remain the same or even increase (in face of the deficit). I perceive the tax burden merely being shifted from one segment to the other, with NO decrease overall. The way the law appears to be headed the shift would be from the upper income to the middle and lower class. Since Idaho is largely in the latter two categories it looks like Idaho might bear a greater portion of taxes than before.

3) Idaho would like to cultivate the retirment sector more, and the disallowance of any second home interest would dash that potential economic boon.

4) These are just a few of the items that come to mind. My personal feeling is that you can not have fair taxes, simple taxes, low deficits, and low taxes. I feel that everyone is concentrating (or being led to concentrate) on the lesser rates within the brackets, not that effect it would have on them-some will win, some will loose. It appears to me that the middle and lower class will loose again. For instance, the upper tax bracket would love to trade the 10% investment credit (which due to the alternative minimum tax is less useful to them anyway) for a reduction from 50% to 35%, while the lower class may be deprived of the credit and actually have their bracket increased! It appears that the redistribution of our countries taxes is downward.

Sincerely,

Tom Baker

Tom Baker

B.N.FEMREITE
2770 HOMESTEAD LN.
IDAHO FALLS, IDAHO 83401

8/1/85

Senator Steve Symms
Senate Office Buildings
Washington, D.C. 20510

Subject: Tax Reform

Ref: Your hearing notice

Dear Senator Symms,

Thank you for your invitation to comment on the administration's tax reform proposals prior to your hearings in Idaho during August. As a responsible employer in Idaho and as an employee, I have some serious concerns.

I have been generally supportive of most of the larger concepts involved in proposed changes to the federal tax system. However, as I learn more of the detailed, subtle changes, I become alarmed. It is apparent that more indirect taxes are actually going to be levied which would offset any reductions in the income tax rate. Specific provisions would severely affect the ability of working people to save for their old age via employer (company) savings programs.

I would like enlist your help in preventing the following specific changes:

1.The proposal would prevent working people from having access to their personal tax-paid contributions in employers' (companies) long-term savings plans. This feature is frequently used by people paying their children's college expenses and to meet unforeseen emergencies. Instead, they would be forced to withdraw company-contributed funds first and pay both income tax and excise tax on the withdrawal. Their personal tax-paid contributions would not be available until the other funds were expended and taxed.

2.Borrowing from such a fund would be taxed much as a disbursement rather than as a bonafide loan which is paid back the same as a commercial loan.

3.Upon retirement, these long-term savings programs would be taxed without benefit of capital gains rates and would be subject to an additional excise tax. This cuts deeply into one of the few forms of long-term savings that are in place for working people. It clearly penalizes those who are attempting to provide for their old age and to educate their children; it exacerbates the predicted Social Security problems.

Many working people and responsible employers have developed these savings plans out of a clear need to provide some financial security for middle and old age. These tax proposals would gut these programs. They are a slap in our face and appear to be a masterful deception.

I will appreciate your help in preventing these changes and others which unfairly tax these plans, impose excise taxes, and threaten our ability to contribute to our own support when we can no longer work.

Yours Truly

August 13, 1985

Honorable Steve Symms
UNITED STATES SENATE (Idaho)
Senate Office Building
Washington, D. C.

Re: Tax Reform Legislation Meeting In Idaho Falls, Idaho August 13, 1985, and Other Things:

Dear Senator Symms:

A study of the Internal Revenue Code published by the Research Institute of America, Inc.,(includes all new tax laws through 1983) it is evident that the IRC is in fact--only a Treaty. This is manifest by the Sections 892, 893, 894, and 895, among others in the entire Code.

Reading in the miscellaneous provisions of the Code Treaty, one finds at Section 7852(d), Title 26: Treaty Obligations:

> "(d)No provisions of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

It is manifestly clear that the Treaty of Paris of 1783 embodied in the Preamble Treaty of the People to the Constitution of the United States of America is, (1) either a Treaty obligation of the United States wherein application of Title 26 would be contrary to: (2) by some means contrary to the preamble--that Treaty has been abrogated unlawfully: This is manifest by the congressional intent in the Privacy Act of 1974 (5 USC § 552a) wherein the Citizens of this Union would have and enjoy all rights securred by the Constitution and Laws of the United States.

But in the same Section above mentioned, 26 USC § 7852, at the subsection (e) (§ 7852(e) PRIVACY ACT OF 1974 one finds a repeal of the Constitutional provisions guarranteeing individual rights by the provisions:

(§ 7852(e)) The provisions of subsections (d)(2), (3), and (4) of section 552a of title 5, United States Code, shall not be applied, directly or indirectly, to the determination of the existence or possible existence of liablity (or the amount thereof) of any person for any tax, penalty, interest, fine, forfeiture, or other imposition or offense to which the provisions of this title apply.

SENATOR: Title 26 United States Code (IRC) is unconstitutional in its attempt to repeal the Constitution and Positive Law. Therefore, all you are securing in your meeting here is the subject people's consent to the annullment of the Preamble and the Constitution.

Which said consent arrangement is by the provisions of the Law (treaty) at Sections 931 and 932 of the IR Code, and the footnotes thereto, wherein--We The People of the United States have been subordinated to the status of "citizens of the United States or Domestic Corporations" or citizens of possessions of the United States. This is also a provision of the before-mentioned section 552a (5 USC 552a) subsection (m) GOVERNMENT CONTRACTORS wherein it is found:

> "(m) when an agency provides by a contract for the operation by or on behalf of the agency of a system of records to accomplish an agency function, the agency shall, consistent with its authority, cause the requirements of this section to be applied to such system. For purposes of subsection (i) of this section any such contractor and any employee of such contractor, if such contract is agreed to on or after the effective date of this section, shall be considered to be an employee of an agency."

By the Tax exemptions; and by the Federal Grants in Aid or Revenue Shareing Funds: You, by trickery and deceit attempt to get the local Citizen/subjects to consent further to the total loss of liberty and domestic tranquility by the enforcament of the New Federalism under the World Government created under the United Nations Treaty since 1959.

Can these People, Citizen/Subjects of domestic corporations really trust the so-called Senator from Idaho--The Senator from Idaho being a Citizen of an Domestic Corporation--SYMMS FRUIT RANCH, INC.

Something is terribly wrong in OUR Government. We have been deceived. Have you been deceived too, Senator, or just a part of the problem? Wake-up, tell it like it is--that we must restore Government to/under the Constitution of the United States--not government under the IRC/IRS Tax Treaty.

Thank you for your consideration, I want to support you and the Constitution. Will you support me and the Constitution of "WE" the People, without any new taxes untill the tax treaty is repealed?

Respectfully, for God and Country,

Edward J. Fuller

Edward J. Fuller
UNITED STATES CITIZEN

1301 Spratt Avenue
Idaho Falls, Idaho 83401
Ph. 523 3469 (208)

The Honorable Senator
Steve Symms
% Joseph J. Cobb
Joint Economic Committee
SD-G01 Senate Office Building
Washington, D.C.20510

August 3, 1985

Dear Sir:

Thank you for your information card on the administration's tax reform. It is with restrained emotions that I undertake to inform you of my family's views on tax reform. It is not easy to be cordial on this particular issue, not just for me; but from all with whom I talk to about tax reform. Reasoning is of course, the fact that there are more interest groups outside of the largest tax payer group, who through their lobbying, exercises influence over the congress, beyond their impact in voting power. This exercise of power beyond their voting right, is of course the mechanism by which they rob the average American of his own rights, the right to equality under the law. It is with this in mind that I choose to speak with the strictest caution.

The objective purpose of all organized free society's is, through the business of their congress; to implement the highest form of free enterprise. without yielding the personal rights of individuals to the domination of organization. Organization either established by that congress, or, born as a result of either action or inaction by that same congress, should not be established in such a manner as grant franchise. Franchise is of course the most common form of discrimination against specific individuals, exercised by powered body's. If one applied this criteria to the present or proposed tax packages, the common result would be the overwhelming defeat of both systems.

The second point that occupies a most dominate station on the horizon of freedom, is the point of equity. The Judicial system is within the constitution charged with adjudicating its application in all cases of law, or otherwise. This responsibility is not something that is at the mercy of any congress, rather its place in the constitution is separate from law. It stands alone as a law of its own, not subject to arbitration by any group or party. Equity is a more powerful force than law when properly considered, simply because, law can be so constructed as to be in-equitable in it finest sense, and still be law. Equity on the other hand, cannot be structured in any form to be in-equitable, and still be equity. Equity is a superior force in our constitution to the rule of law, rule of law can be interpreted and changed to form a structured set of rules than are adaptable to circumstances and events. While equity cannot be interpreted in any manner other than through the criteria of equal, it is not subject to form changes, such as those experienced by law. Its only problem is the tendency of those responsible to ignore it as a substance of philosophical law, and pass laws that are expedient to the emotion of the moment, without consideration of its proper place in the American social structure. This is especially true of the judiciary.

History tell us that the rule of equity has been virtually ignored as a responsibility by the American judicial system. In fact I know of no cases that have ever been adjudicated by any court in the U.S., that is founded solely on the rule of equity. If all congressional laws (congressional in the sense of all organized elective administrative groups of a society, plus all Appointed Administrative Bodies, whose rules and and administrative judgments have the same force as law.) were scrutinized by the judicial branch, to determine their content of equity, I sincerely doubt that any would survive, as constitutionally legal. This Senator is the most serious charge ever labeled against administrative activity (regardless of it base) in the United States Of America.

With this understanding between us, then I will attempt to contribute to the reform of tax with the blessings of my Family of forty. I do not ask for agreement from you on my own interpetation of equity, but do ask your indulgence, please.

Our Views

Tax in the sense of its application should be established as two distinct systems. One system dealing with the living group of tax payers, citizens. And the other dealing with established entities, such as companies, corporations, partnerships, trusts, etc, etc. The reason for this distinction is the two entities (persons and organizations) can not be equitably compared.One is a God created living entity subject to the rules of nature, and society, while the other is a man created entity subject to the rules of man. The one dies, while the other knows only the death of failure.

The tax system governing man, should consider equity as the highest governing force, of its structure. Such a tax system would as a natural step consider the total environment of the living human. Environment in the sense that all social activities are a controlling force on his individuality, and influence, his quality of life, including the social activities of his fellow man and the influences of the man created entities. Therefore its structure should have a very special place in its force for the full social protection of his health.

Based on the preceding paragraphs and the philosophy contained therein, The following recommendations are carefully explained Those suggestions are designed to perform the taxing of the social human in the most equitable fashion possible, with consideration of the individual liberty and station in society.

A medical tax of two percent should be deducted from all gross earnings of both entities, business and human. There should also be a three percent tax on the net earnings of all, human and business. This medical tax should be invested in a trust that procures through the process of bids, medical insurance for the human form in numbers not to exceed one million in number, this insurance will be purchased from the organized insurance organizations, already in existence. All insurance groups of one million, as groups will be picked by random computer to form an insurance group regardless of their state of residence. Family structure will be honored in the random computer groups. Private companies should be excluded, while the qualification for a bidder, would be its eighty percent ownership by the general public as traded through the organized stock exchanges. Any time general public ownership fell below eighty percent, then the insurance bidder should immediately be excluded from all subsequent contractual activities. This would serve to control medical cost in a most equitable manner, whereby the bidding insurance companies are business operated for a profit, therefore they will control the medical cost as a matter of profit policy. Their medical profits should be limited to a national high of seven percent of net. All profits exceeding seven percent would be returned to the trust fund. Bid cost are not subject to escalation during its time of force. All private Doctor owned corporations would be barred from being an insurance bidder.

Under this plan all medical health care would be equitable for all, rich and poor. If the rich desired better health care than the poor, then they would have to leave the country to get it. However, they would probably be getting the best in the world.

Human tax should be levied in the following manner: The only deduction allowable would be, (1) Single Home Interest (one the payer lives in), (2) Charitable gifts up to $10,000.00, and nothing else. Tax should follow the philosophy herein. Zero tax on the first ten thousand dollars. Ten percent tax on the next twenty five thousand dollars. Fifteen percent tax on the next fifty thousand dollars. Twenty percent tax on the next one hundred thousand dollars. Thirty percent tax on the next three hundred thousand dollars. Forty percent tax on the next one million dollars. And fifty percent on all the earnings that exceed one million dollars, up to five million dollars. All earnings that exceed five million dollars, should be taxed at ninety percent.

All gifts or gratuities of any type to all humans would be fifty percent of one half and ninety percent of the other half. This would include the actual value of company cars, boats, and air planes used for the personal benefit (personal benefit in the strictest sense) of its employees, regardless of the reasoning for their use. All interest, stock, and investment earnings of any type, should be treated the same as income for all. All humans should be treated the same, this type of taxing system recognizes the distinctive difference in the individual abilities and life style.

Entity tax should be based on the consideration that all entity tax is a function of the business sense of the individual, and his ability to succeed. Therefore the tax on all entities, should be so structured as to give the entity that opportunity without government franchisement. This can be accomplished by the following taxing policies. (1) All net earnings up to twenty five thousand dollars should be taxed at a rate of ten percent. (2) The next fifty thousand dollars should be taxed at a rate of fifteen percent. (3) The next seventy five thousand dollars, and up to three hundred thousand dollars, should be taxed at a rate of twenty percent. When dividends are paid out, and deducted from the net, the remainder should taxed at a rate governing that amount.. (4) All of the next net earnings above three hundred thousand dollars, and up to one million dollars, should be taxed at a rate thirty five percent. (5) All net earnings that exceed one million dollars, and up to five hundred million dollars, should be taxed at a rate of forty percent. (6) All net earnings that exceed five hundred million dollars, and up to one billion dollars, should be taxed at a rate of sixty five percent. (7) All net earnings that exceed one billion dollars, and up to two billion dollars should be taxed at a rate of seventy five percent. All net income that exceeds two billion dollars should be taxed at a rate of ninety percent.

Paid out dividends may be deducted from the net earnings, and the prevailing tax rates in the adjusted amount would prevail.

All would be allowed to deduct from their net earnings, the medical taxes paid as a function of their gross earnings. Gross earnings are considered as their annual cash flow before deduction of operating expenses.

The reason for this type of progressive tax is to force Corporations and other high earners to pay the maximum dividend, or face a sharp tax as a penalty.

The obvious is that if some corporation or other high money earner, should pay more than their share of tax if they do not return a dividend. If they pay out a dividend, then the tax burden is shifted to the stock holder, and they will pay their own applied tax rate.

All of the credit bull, and the deduction sham should be done away with. If it is unprofitable to operate a business, then they should be allowed to go broke, without the average American financing their operations, it's called free enterprise, and initiative.

One final thought: If a business reaches the age of one hundred years, then it should be taxed with a ten percent surcharge, on their normal tax rate, for each ten years over the hundred year age. This would put the business in the dyeing game just like a man is.

Foundations and trusts should be terminated after twenty five years of existence. This would force the Rockefellers and the Kennedys to work for a living just like every one else. Non profit corporations and trusts should be allowed to survive for only fifty years, before they are dissolved.

I am always sincere,

Robert [illegible]
P.O. Box 164
Lewiston, ID 83501-0164

Kuska Bookkeeping and Tax Service

August 30, 1985

Joseph J. Cobb
Joint Economic Committee
SD-G01 Seante Office Building
Washington, D.C. 20510

To Whom It May Concern:

Attached is a copy of a letter to Rep. Craig stating some of my opinions on tax reform. I thought you might also find it helpful.

Sincerely,

Ginny Kuska

Ginny Kuska

307 S. Main St. Moscow Idaho 83843 1-208-882-5600

Kuska Bookkeeping and Tax Service

August 22, 1985

Honorable Larry Craig
1318 Longworth Bldg.
Washington, DC 20515

Dear Mr. Craig,

I am an individual tax payer and a small business owner and would like to comment on the proposed tax law changes.

First as an individual taxpayer, my situation is that I am divorced with 3 children and am self employed. I get $200 child support per month during the 6 month that I have the children living with me. It costs me approximately $1,600 per month to provide the bare basics for my family. Because I am self employed I also have to pay my own health insurance and retirement (no paid vacations, sick leave, etc.). This adds another $150 to my monthly expenses. Annually I need approximately $20,000 to provide just the bare necessities. As a self employed person this means I have to show a net profit of more than $30,000 because at least one third goes to taxes. I file head of household and claim 2 exemptions and do not itemize. My taxes for 1985 on a projected $30,000 net profit will be:

Social Security	(11.8%)	3,540
Federal Taxes	(28%)	4,931
State Taxes	(5%)	1,622
Total taxes		10,093

Effective tax rate 33.74%

I have never in my 6 years of being in business been able to show a $30,000 net profit. I have a service orientated business doing computerized bookkeeping and tax preparation. With a profit margin of 50% I would have to have gross income of $60,000 a year or $5,000 per month or $250-300 per day. For a one person office in Idaho, this is difficult to do. It also discourages me to think that if I could be employed and receive a salary of $30,000 my taxes would be:

Social Security	(7.05%)	2,115
Federal Tax	(28.%)	4,931
State Tax	(5.%)	1,622
Total taxes		8,668

By being employed I would save $1,425 in social security taxes and my health insurance, retirement, and other fringe benefits

307 S. Main St. Moscow Idaho 83843 1-208-882-5600

would be provided and would be tax free. However, even though I am a college graduate, there are no jobs available to me that pay that kind of salary, and I prefer to be self employed but am frustrated when I am financially penalized through taxes.

Small business is the backbone of our country and I think deserves more support and encouragement through changes in our tax laws. From my experience of being a small business owner and having worked with many other small businesses in the area I would like to make the following observations.

1. Complexity of paperwork and difficult to understand forms have caused many small businesses to not report wages. Surely these forms and rules can be simplified.

2. The self employed's large portion of social security tax - 11.8% is such a large amount and nearly 5% more than an individual employee pays. Everyone doubts seeing the benefits of social security. Wouldn't this grow faster and give one a feeling of being in control if it could be put in a retirement fund of one's choice.

3, Depreciation schedules. The ACRS was an attempt to simplify but when all the twists and turns came in - re-capturing excess depreciation, reducing basis by 1/2 of investment credit taken it became a nightmare to keep track of even a $250 item. Why not let companies expense the 1st $50,000 to $100,000 of equipment purchased. The money saved in paperwork and the encouragement it would give to buy capital assets would reduce costs to the consumer and encourage growth.

4. Have IRS (and legislatures who propose complicated tax changes) comply with the Small Business Regulatory Flexibility Act so that they would have to do impact studies to see if changes are more harsh or discriminating to small firms.

5. Make tax rules uniform, consistent and easy to administer. This means not making changes effective in mid-year so extra computations have to be made, or complicated formulas like figuring the taxable social security benefits. This confuses people, angers them and creates a very negative attitude towards the IRS who are merely enforcing the changes the legislatures impose.

6. Companies should be able to make monthly FICA deposits. Have everyone deposit once a month instead of some having to do it 8 times and others only quarterly.

7. Allow all businesses to treat fringe benefits alike. If a corporation can deduct health insurance and retirement costs and business expenses then so should the sole proprietor.

8. Lower the proposed tax rates. The proposed rates are still too harsh on low income people. I would propose that no one who makes 10,000 or less should have to pay income taxes or social security taxes. I would propose the following for a single person:

0-10,000	no tax
10,000 - 35,000	15%
35,000 - 60,000	25%
60,000 + up	35%

I truly believe people are willing to pay their fair share if they can understand what they owe, why, and how the money is used. If necessary, the government should hire a professional public relation company. In the private sector, time and effort is put into making systems run smoothly and efficiently. The tax situation as it works today encourages us all to be liars and cheats, to feel frustrated and to be dependent on others to figure out what we voluntarily owe. As a tax preparer I feel guilty having to charge people to help them figure out their taxes but I can understand why they seek help.

In closing I would summarize by saying there is a real need to simplify and to support small business. Any efforts on your part to see that the new tax reform moves in this direction would be commendable.

Sincerely,

Ginny Kuska

Ginny Kuska

cc: National Federation of Independent Business
Department T
600 Maryland Ave., S.W., Suite 700
Washington DC 20024

School Finance

Ed. 611

Dr. Fossard

In response to your mailed request from Senator Dymally I am enclosing my personal report on Tax Reform.

Mike Hoffman.

Personal Income Tax Reform and Education Revenue

by

Mike Hoffman

[illegible] [illegible] very [illegible] in [illegible]

Personal Income Tax Reform and Education Revenue

Reducing the personal income tax rates and broadening the tax base are frequently mentioned in regards to tax reform. Legislators and tax reformists are searching a continuum of compromise ideas from a flat rate on one side to further delineations of the existing tax structure on the other.

Rep. Crane (R. - Ill.) is confident reduced rates from 10 to 14 per cent would raise an equivalent tax revenue with more economy of administration.[1] The hearings before the Committee on Finance United States Senate mention, "Several of the proposals appear to be designed so that the new combination of tax rates and tax base would produce approximately the same revenue as is expected under present law for either 1983 or 1984."[2]

But rate and base adjustment will alter the distribution and require a difficult political consensus. For example, "The nations charities have" . . . hired Martin Feldstien, former chief advisor to the President, to help in the battle to preserve the full slate of charitable deductions."[3]

To the extent that social goals compromise the simplicity of the flat or reduced rate we may again rebuild the present tax code and defeat real tax reform. To gain support tax reformists allow the standard deduction for the poor; medical and casualty deductions for those "who have suffered enough"; after tax dollars for the aged;

and state and local tax deductions for the social benefits we desire.[4]

Educational support for a particular tax reform bill keys on favorable federal deductible status of property taxes, sales taxes, and local taxes, on the state income tax return. This is well established, but should educators and others examine tax reform from an entire system approach?

Mark Skousen suggests that we recognize the 1040A as a current flat tax rate. "everyone would use this simple form if it were not for the high tax rates which encourages millions of taxpayers to itemize their deductions."[5] Skousen's proposal would offer each taxpayer a choice between a new, lower, simple, flat rate and the existing long form rates as a safety net or a security blanket. Each taxpayer would decide if the extra effort to execute a long form would be in his financial interest. Perhaps choise would reduce resistence.

Rep. Crane further writes, "A flat rate tax would certainly tap some of the 'underground economy' which is now pegged at almost $399,000,000,000. This figure translates to almost $100,000,000,000. in uncollected taxes. The greater part of this is represented by unreported income of individuals. . ."[6]

Also, Rep. Mark Siljander (R. - Mich.), and Sen. Don Nickles (R - Okla.), "assume that their lower tax rate of 10 percent, plus other modifications, will stimulate compensating revenues, including money currently lost to the underground economy and other forms of tax cheating. The bill offers an amnesty program for three years to recover and capture that revenue source."[7]

Is the following a valid analogy? Suppose that some property were discovered in a school district upon which no property tax was levied. Would educators and others be interested in recovering the lost tax revenue? Yes, of course. Suppose the underground economy could be identified in a school district. Would educators and others be interested in recovering the lost personal income tax revenue? I think so. The steps the school district would take to recover lost property and sales tax monies might also be considered for the lost state income tax revenues due to the underground economy.

How will this happen

In the first instance, our complaint would be to those who assess the property tax, and in the second our complaint should also be with those who levy the tax, the Federal Government, and the state government.

In the area of lost property tax revenue due to Federal impact the school district recieves Public Law 874 money. Shouldn't the Federal or State Government logically be sensitive to lost personal income tax money to the state and the school district. The linkage is not direct, but the logic is the same.

Perhaps the school district, state, and others have legal recourse through the courts to require more equitible collection practices to recover lost personal income tax revenue.

1. Philip M. Crane, "A Flat Rate Tax on Income - a Fair Tax" USA Today, Sept 1984., pp. 27-28.

2. See Hearings Before the Committee On Finance, United States Senate, Ninety-Seventh Congress, Second Session, September 28, And 29, 1982, Part 1 of 2. p. 20.

3. M. Richard Maxfield, "How Will Tax Reform Affect You?" Freeman Digest, April 1985, p. 10.

4. See Hearings Before the Committee on Finance, United States Senate, Ninety-Eighth Congress, Second Session, August 7, 8 And 9, Sept. 11 and 20, 1984, Part 2 of 2, p. 16.

5. Maxfield, op. cit., p. 10.

6. Crane, op. cit., p. 28.

7. Maxfield, op. cit., p. 8.

Bill Ahlfeld's

Forest Industry AFFAIRS

FOR THE PAPER AND WOOD INDUSTRIES • P.O. BOX 19187 • WASHINGTON, D.C. 20036 • TELEPHONE (301) 320-3416

Rex L. Dorman

AUG 1 1985

July 25, 1985
Vol. 18, No. 11

This issue of FIA departs from the usual format to address a longer **Memo to Congress.**

MEMO TO CONGRESS

The subject: what the proposed loss of timber capital gains and expensing of forest management costs would mean to industry, about seven million private forest landowners, forest productivity, and **our nation's future timber supply.**

DEAR CONGRESSIONAL MEMBER:

During your August reprieve from Washington's heat, please take a little time to weigh the consequence of making a change in the tax code that provides so **little short-term benefits** and has such **great long-term costs.**

Capital gains treatment for timber has been reviewed and justified by Congress many times. For some of your colleagues, mention of the subject leads to glazed eyes and calls for another scotch.

Each review found the objective--to encourage greater forest productivity and adequate future wood supplies--was achieved by tax treatment that recognized timber's unique character as a capital asset.

Nothing about the character of timber has changed. Nature still does its job but needs a helping hand to meet our future forest product needs. Trees must continue to be planted today and managed today!

The Administration's proposed tax changes, however, would result in **fewer trees planted** and **lost tree growth.** This loss, by the way, could not be recouped later by changing the law back. More intensive future planting efforts could not make up for lost wood volume. The simple reason is--a tree takes a long time to grow.

WHAT ARE THE CHANGES? Current law permits a taxpayer to deduct each year the costs of managing his timber after the seedlings are established, property taxes, and interest. These expenses would now have to be capitalized. After forty years in the tax code, capital gains treatment for timber would be repealed. So would the provision that permits small timber owners to write off up to $10,000 of reforestation expenses each year for seven years and to claim a 10% investment tax credit.

WHAT WOULD THE CHANGES DO? If you vote these changes, the results would include:

- shortages (not right away, perhaps, while Canada continues to deplete its forests to send us "subsidized" lumber, but eventually);

- sharp price increases (which would affect the price of homes and a myriad of wood and paper products);

COPYRIGHT 1985 BY AHLFELD & ASSOCIATES, INC. ALL RIGHTS RESERVED

- dependence on inadequate substitutes (materials that are energy intensive to produce and not renewable like wood); and

- **MORE IMPORTS.** (Do we really need another negative in our nation's trade deficit?)

These "reforms" in the tax code would obviously hurt companies and individuals. But they would also harm many dependent communities, often those small towns in rural areas where there are few other economic or job opportunities.

Economists often point to market forces as the way to resolve such problems. So, they argue, if a shortage occurs, prices will rise, and people will grow trees again.

Unfortunately, as noted, it's a long investment cycle from seedling to mature tree. Thus, time shoots down the theory that our nation's timber supply can rely on short-term price rises. Sure, you could cut more trees (speed up harvest) to react to a peak in demand or price. But new supplies for the longer run come only by increased planting and continued intensive management.

Much of our future wood supply depends on private, non-industrial landowners who own most of our nation's commercial forest land. Together with industrial ownerships, 70% of the lands we must rely on for wood and paper are in private hands.

Unfortunately, the individual tree farmer's return on his forest investment has been no bargain. One study of an investment in Southern pine shows it averages about 10%. That kind of return, plus other factors, tends to discourage investment in growing trees even without changing the tax code. Consider:

First, you have substantial front-end investment in land and planting costs.

Then, you've got annual outlays for management, or the carrying costs, for about forty years. During this time there is no positive cash flow.

And during this time, your timber's value can be affected by unpredictable risks--weather, insects, disease, and fire. Timber owners find commercial insurance against such losses unavailable.

Given these **discouragements** to timber investment, most industrialized countries provide those willing to grow trees some form of preferential tax treatment. They **encourage** investment in their country's future timber supply through tax credits, special expense deductions, and favorable treatment of gains from the sale of timber.

Before the exchange rate got out of hand, U.S. forest product companies were strong competitors in world markets. They still are cost-effective, modern, and well-positioned today to serve overseas markets. It would be irrational to place them at a further disadvantage because of other countries' tax incentives.

What individual--as well as company--forest owners want is **fair tax treatment.** To be fair, our tax code should continue to recognize the long-term, high-risk nature of an investment in tree growing. It should acknowledge, also, what competitive nations offer their tree growers. If it is not going to be fair, then capital needed for planting and managing trees will flow elsewhere.

Before you say "so what?", order another scotch and consider how our existing timber tax policy came about: Not long after Congress enacted a national income tax, legislators realized a distinction should be made between ordinary income (wages, salaries, dividends, etc.) and the increase in value of long-term capital assets.

In 1921, tax experts say, we adopted a formula for taxing the gain realized when a capital asset is transferred. Although some countries excluded such gain from taxes altogether, we at least decided to soften the burden.

The theory behind this tax treatment was . . . if an investor left his money in an asset for a period of time specified by law, he should be rewarded for the long-term risk taken and allowed to keep a larger share of the growth in value he helped create. More than, say, a speculator dealing in a short-term roll of the dice.

In those early years, timber was eligible for the capital gains rate but only when liquidated or disposed of in a lump-sum sale. Forest management for sustained-yield was not then recognized for capital gains purposes.

In other words, if you sold your timber gradually under a cutting agreement, or cut it for processing in your own mill, any proceeds were taxed at ordinary income tax rates--generally twice the rate applying to other capital transactions. This is basically what the changes in the code take us back to--the situation that existed prior to 1944.

However, the result of this approach, prior to 1944, was painfully clear--**our forest resource did not grow. It declined!**

In 1944, however, a dramatic change occurred. Congress decided to encourage forest management for a continuous supply of timber. For over forty years now--**about the average length of time it takes to grow a tree**--timber has been treated similarly to other capital assets. Whether sold outright, managed and sold under contract, or processed in the owner's plant made no difference.

If the specified holding period is satisfied, then the difference between the cost and sales price--or the market value of the standing timber--is the "capital gain" and is taxed at the long-term capital gain rate. Any added value after the harvest, e.g., processing or marketing of forest products, is taxed at ordinary income rates.

The record shows what happened after enactment of those timber capital gains provisions. Before 1944, our country had less timber at the end of every year than at the start. After fair tax treatment became effective, that trend was reversed. We had **the most dramatic growth in private forestry in our history.**

There was greater stability in forest regions than in the earlier period. Local tax revenues grew in those nearby, basically rural communities. Mills were built. Small lumber manufacturers were more competitive, as they could save capital and use harvesting contracts instead of having to buy timber on a lump-sum basis.

That's the background. Now what? According to the Forest Industries Committee on Timber Valuation and Taxation:

"The Administration's proposals . . . would not only penalize forestry and timber regeneration but would encourage poor management or no management. They would reverse four decades of progress in assuring continuous availability of timber in the United States."

Under proposed changes in the code, some timber owners can receive capital gains treatment--provided they don't manage their timberland and sell their timber outright. If they do practice sound forestry and try to increase productivity, they are required to pay the much higher ordinary income tax rates. Make sense?

Tree farmers and industry executives alike agree that proposed capitalization of carrying costs is an equal, and in some respects greater, blow to growing trees than the loss of timber capital gains. It singles out the timber grower for unfair treatment. Owners of all other assets are allowed to deduct management, protection, and carrying costs.

The bottom line--these proposed changes are **unfair** to those who planted and managed their forests for decades counting on a tax code that encouraged them to do so; they will cause a decline in forest productivity, disrupt one more of our nation's basic industries, lead to shortages, higher prices, and more red ink for our trade accounts.

Most ironic of all, if enacted they will do very little to help correct the deficit.

Sincerely,

Bill Ahlfeld